BUSINESS POLICY CASES

With Behavioral Science Implications

Merwin M. Hargrove
Ike H. Harrison
and
Eugene L. Swearingen

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Grid I, -- MANAGEMENT FUNCTIONS, and Grid II, -- BEHAVIORAL ASPECTS, are presented as aids to the student as he prepares the cases for classroom discussion.

The horizontal coordinates of Grid I are the core areas of collegiate business education. The student is presumed to have covered the subject matter of each of these areas as he advanced in his business studies through the prerequisites to this Business Policies course. The vertical coordinates are the functions performed by a manager.

By keeping this grid in mind, the student should be helped to integrate the knowledge and experience he has acquired with the functions he is to perform as a manager, using the data supplied in the cases as practice materials. Since all cases report on actual companies, actual people, and actual situations, the student is practicing with realistic materials.

Accounting

Economics

Finance

Legal Aspects

Management

Marketing

Statistics

GRID II

	Role as the man sees it as others see it	**Conflict, Competition, Cooperation** man-to-man man-to-group group-to-group	**Adjustments as to** Economic conditions Technological conditions and other Societal conditions
Man-to-Himself			
Man-to-Man			
Man-to-Group			
Man-to-Environment			
Group-to-Group			

The student should keep in mind the coordinates of Grid II, BEHAVIORAL ASPECTS, as he evaluates the behavior of the people working within the firm under scrutiny. The student will find it convenient to consider their behavior patterns in light of how they may be plotted on this grid.

For example, the scope of the patterns may be restricted to within the man, or it may be more extensive involving another man, a group, or even between groups. Or, it may be a man-to-his environment situation.

At the same time, it may be a role problem; or a problem of conflict, competition, or cooperation; or an adjustment to economic, technological, or other societal conditions.

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RICHARD D. IRWIN, INC.
1963
Homewood, Illinois

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First Printing, May, 1963

The Library of Congress Catalog Card No. 63–14227

PRINTED IN THE UNITED STATES OF AMERICA

Preface

In recent years there has been a trend in schools of business to have an integrating course to consolidate the information which students have studied in the core subjects of the business curriculum. The purpose of this book is to provide a framework for such an integrating course through business policy cases that have behavioral science implications.

The thirty-one cases in this book were written by members of the Southern Case Writers Association. This organization is composed for the most part of university professors who have attended the Summer Case Writing Seminars sponsored by The Ford Foundation at the Graduate School of Business Administration at Harvard University since 1955. The list of authors and their academic affiliation at the time of writing the cases includes J. Leslie Bayless, Louisiana Polytechnic Institute; Frederic A. Brett, University of Alabama; Edward C. Burris, Oklahoma State University; James E. Chapman, Georgia State College; William H. Day, University of Tulsa; Robert R. Dince, University of Georgia; Merwin M. Hargrove, University of Tulsa; Ike H. Harrison, Texas Christian University; Robert D. Hay, University of Arkansas; William T. Hicks, University of Mississippi; Virgil A. James, University of Texas; Henry Key, Texas Christian University; Randolph G. Kinabrew, University of Mississippi; Preston L. LeBreton, Louisiana State University; Leon C. Megginson, Louisiana State University; H. R. Smith, University of Georgia; Eugene L. Swearingen, Oklahoma State University; Curtis E. Tate, University of Georgia; Lyle R. Trueblood, University of Tulsa; Arthur G. Vieth, University of Chattanooga; and Vern H. Vincent, West Virginia University.

A number of professors in the South who had attended these seminars at Harvard University felt it would be desirable to band together and exchange experiences. From this informal organization came the Southern Case Writers Association. In 1959 The Ford Foundation made a two-year grant to this organization to sponsor research in case writing.

The Southern Case Writers set as an objective the development of business policy cases which had behavioral science implications. In order to achieve this goal, four outstanding behavioral scientists agreed to participate with the Southern Case Writers in summer seminars. These scientists were Dr. Raymond Bauer of the Graduate School of Business Administration of Harvard University; Dr. Nicholas Demerath, Director of the Social Science Institute of Washington University in St. Louis; Dr. Howard Baumgartel, Chairman of the Department of Human Relations at the University of Kansas; and Dr. Fred L. Bates, Professor of Sociology, Louisiana State University.

The thirty-one cases contained in this book deal with small, medium, and large businesses and cover a wide range of industries and locale. By industries, the cases range from ranching operations to food distribution to the petroleum industry.

Each of the cases covers at least two of the functional areas of business. These cases provide a framework through which the student can analyze a business policy case in terms of the planning, organizing, evaluating, and controlling functions of management. The cases can further be analyzed in terms of the core areas of the business curriculum: accounting, business law, economics, finance, personnel and production management, and marketing. In addition, each case may be used to examine the behavioral science implications found in business operations.

The Southern Case Writers wish to express their appreciation to The Ford Foundation for the grants which made the writing of these cases possible. Dr. Thomas Carroll, Dr. Neal Chamberlain, Dr. Donald O'Connell, and Dr. Oscar Harkavy, all formerly of The Ford Foundation, were particularly helpful to the group in this research program. Acknowledgment is given to Professor Andrew Towl, Director of Case Development at the Graduate School of Business Administration of Harvard University, who encouraged each of the authors to continue case research.

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Tulsa, Oklahoma
October 1, 1962

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Introduction

The Managerial Process

Decision making has been called the most characteristic task of the executive. Within a company, hundreds of decisions may be made daily, and an important executive may be weighing the relative merits of many solutions to several problems during the same day. Those who make decisions feel pressure. The degree of pressure increases when the decisions affect more and more persons. The making of simple decisions often becomes routine. However, the decisions which the chief executive makes are more intricate, and they frequently affect the future of many men and women.

Management has been called the oldest of the arts and the youngest of the professions. While it might be argued that managers have not yet attained full professional status, they are approaching this goal. The growing complexity of business, the increased size and scope of business firms, technological advances, automation, governmental regulations, competition, and many other factors make necessary vast knowledge and great skill in those responsible for administration.

Professional managers must be able to analyze complex and critical problems and make decisions. They must set the objectives, establish the policies, make the plans, and formulate the procedures necessary for successful operations. They must effectively motivate and direct people. They must control the activities. They must measure and evaluate the results. And above all else, they must supply the creative thinking that leads to innovations. These innovations bring progress in new production processes, new administrative procedures, improved products, and better relations with all publics.

The manager must size up a problem, conceive promising alternatives, mentally weigh their consequences in terms of the objectives of the firm, and choose the alternative he thinks is best. The purpose of the cases presented in this book is to help the student develop these managerial skills. Opportunities are presented to size up many varied problems. Knowledge, experience, and imagination will help the student conceive many promising alternatives. An almost unlimited series of consequences may be considered in deciding the most promising line of action.

Education for Business Management

Knowledge of business administration can be acquired. Our understanding of business has expanded rapidly in the last few decades. Each new shred of knowledge about business organizations makes its impact on the art, or the skill, of being an executive. The business executive uses this knowledge skillfully to achieve optimum results. Obviously, there is need to keep a balance between the increase in knowledge about business and the improvement in the skill of its usage. One of the most important goals of business education is to lead the student to think like an executive and to act like one.

Although the fund of knowledge about the administration of business enterprises is considerable, formal education in business is of relatively recent origin. The first college of business administration has recently celebrated its seventy-fifth anniversary. Most business schools have originated since World War I. The establishment and growth of specialized collegiate schools of business has been concurrent with the substantial accretion to the fund of knowledge and notable progress in the skill of administration.

Traditionally, major emphasis has been focused on the study of certain areas of business such as accounting, finance, marketing, and production. As inquiry was directed toward these areas, improved programs of study evolved. Theories, concepts, and useful generalizations were framed in thought and proved in practice.

Bookkeeping grew into accounting which, in turn, expanded into budgeting, auditing, tax computing, financial reporting, costing, data processing, and the many other areas of concern to the accountant and controller. With the great expansion of this area of knowledge came the corresponding expertness in the practice. The skill of the professional accountant can be designated now by such terms as certified public accountant, controller, and chief accountant. Today the study of accounting has become a vital part of the educational background of not only the professional accountant but also of all management personnel. Similar evolutions have taken place in finance, marketing, and production.

Some programs of study at the collegiate level have introduced the students to each subject matter area as if it existed separate and apart from the other business subjects. For example, in those instances, accounting has been taught with emphasis on record keeping, analysis, and interpretation only. The human aspects of the situations being accounted for were ignored frequently in the accounting classroom, as were the finance, marketing, and production aspects. It is a mistake for students to assume that accounting, finance, marketing, or production problems occur in seclusion apart from all the other aspects of business.

The Course in Business Policies

In an attempt to break down the notion that there are individual, independent cells of knowledge such as accounting, business law, economics, finance, personnel and production management, marketing, and statistics, many colleges have recognized the need for an integrating course. This course is usually offered at the senior or graduate level and is commonly referred to as a "policy course." One of the primary purposes of this integrating course is to encourage the development of executive skills in using the knowledge acquired in all previous courses and from all previous experience. This can be accomplished by giving the student carefully selected business cases which report conditions faced by executives in existing enterprises. Every case in this book has been taken from an actual business situation. As the student reasons with the facts of these situations, he is expected to draw on his fund of knowledge and experience. Through practice, the skills of decision making are developed.

The Case Method

The teaching of business policy by the case method has gained widespread acceptance in the last few years. The case approach is useful in bridging the gap between learning and practice. In using cases, the student becomes concerned with the overall administrative viewpoint. This viewpoint can be acquired by the student becoming aware of a wide variety of situations found in different companies in the various industries. Since it is presumed in the case method that the student has authority to act, he is expected to locate the problems, winnow out the relevant facts, and logically arrive at a defensible conclusion.

SUGGESTIONS ON HOW TO PREPARE THE POLICY CASES FOR CLASS DISCUSSIONS

Students frequently inquire about the best way to prepare a policy case for class discussion. There is no one best way to prepare that will be successful for all cases. However, the following suggestions may be helpful:

First, read the case several days before the scheduled discussion period. Second, reread the case carefully before the class meeting. At this reading, it may be well to make notes about the complex parts of the case so as to have all data readily available for discussion. The time interval between the two readings is important since it gives an opportunity to contemplate the lines of action that might be taken.

In reading the case, attention should be focused on the problem situations. Watch for all of the problems reported in the case. Pick out the significant ones. Relate to each problem the facts and data that are significant. After having determined the problems, move toward a tentative decision or commitment by considering what can be done. After a tentative commitment is established, resolve the place and time to begin the alleviating action. Determine whether the proposed solution would cause new and different problems to appear. Evaluate these new problems and their solutions. Are the consequences of the solution of sufficient positive value to the company to justify the recommendation? If not, what else can be proposed and justified? Continue this process of proposals and evaluations of consequences until an answer is found which would satisfy you if you had the sole responsibility for the outcome.

While you are strongly urged to make each preparation independently, informal group discussions prior to the class meetings are helpful. These discussions permit each student to have an advantage comparable to that of the executive who confers with his colleagues about his problems. Often the process of vocalizing the problems and their possible solutions can cause each student to crystallize further his thinking. New considerations may be contributed by each member of the group. Weaknesses in a decision may become apparent when it is challenged by a colleague.

Make a conscious attempt to apply what has been learned in other courses, from reading, and from previous cases. Read related materials that provide background about the case, as well as general articles about administration and policy making found in journals, magazines, and books. Be open-minded and read with discernment. Business knowledge should be useful. Attempt to use what is read. The cases themselves should help you become acquainted with the technical vocabularies used in different companies and industries.

Signs of trouble occur in the cases. The causes of these troubles must be uncovered. The troubles must be treated. There must be some line of action. You must decide what you want done. This means that you must appreciate what the situation is now and determine what you want it to be, giving the necessary steps of moving from the present to the desired situation.

The troubles may be centered in such areas as the objectives of the firm, the policies, the plans, or the procedures. There may be changes taking place which require administrative attention and action. There may be problems of conflict, competition, or cooperation at the various levels of man-to-man, man-to-group, group-to-group, and even societal problems. There may be problems in finance, personnel and production management, or marketing. Or, the problems may be in accounting, in the legal environment of the business, or in economic areas. Whatever the situation, the student must attempt to see the entire problem and all of its implications.

Imprinted on the end sheets of this book you will find two grids, one of which will be useful in analyzing a case from a behavioral science point of view. The other grid will be useful in analyzing a case from the point of view of the functional areas of the business firm. It is suggested that you use these grids as one step in the analysis of cases.

It may appear to you that you do not have enough information to make a rational decision. The executive often feels the same way. Use whatever information is available in the case and through ready references.

Finally, strive for a workable, practical solution. Be tough-minded in defending a logical solution, but do not be closed-minded when colleagues present ideas previously overlooked.

Practice in Decision Making

Decision making needs to be practiced. The practice can start in the college classroom. Life is too short for the business executive to learn from experience all that he should know in an economic society as complex as he faces today. Actually, the business executive needs to know about the entire operation. Often when men are promoted because of successes demonstrated within a functional activity of the enterprise, they have developed only the skill of management within that limited area. The average executive may have a well-developed skill in managing one aspect of a company, but when promoted he may have little or no knowledge of or experience in directing and coordinating an integrated business. Only a few men comprehend the entire program of a company and can direct all of its aspects. Yet, the growing complexity of business requires executives who can grasp the problems confronting the entire organization in our rapidly changing economy. And, good administration is equally important in education, government, religion, and all other functioning groups.

Behavioral Science

In its attempt to prepare students to solve the problems of a complex business world, education for business has been in a ferment. Curricular soul-searching has taken place. Experimentation has been tried. Two important trends have developed in recent years. One trend has been the growing importance of quantitative techniques to assist in decision making. This development has contributed much already and gives promise for the future. The other important trend has been the growing attention to the behavioral sciences. This trend also promises substantial aid to the decision makers now and in the future.

The behavioral scientists in the fields of psychology, sociology, and anthropology have accumulated knowledge about individuals and groups. Much of this knowledge is useful to business executives, and they need to become aware of this scientific approach to management problems. As energies and abilities are directed toward investigation of business problems, theories and practices evolve. While the precise cause-and-effect relationships found in mathematics and the physical sciences are not as readily discernible in the behavioral field, progress is being made. Useful solutions are forthcoming when the spirit of science is present.

Students and young executives often lack confidence when making decisions. It is difficult to predict the consequences of an action when no hard and fast—and perhaps obvious—answer is available. Reliance upon the established knowledge of the behavioral sciences may bring greater assurance to the executive.

Education for business has historically followed, rather than preceded, business practices. Students have been asked to familiarize themselves with the established practices of many organizations. This approach has not been conducive to great progress since the student only learns to perpetuate what is being done. There has been an obvious need for research to evolve theories and concepts. Basic, usable knowledge is being accumulated. Such an approach is tending to reverse the trend education for business has followed. The results of research are being incorporated in college programs today. The business school of the future will attempt to lead rather than follow the business practitioner.

Social Behavior, Policy Making, and the Business Enterprise[*]

Students of business policy and policy makers are properly concerned with tracing and tying together things as they are and as they could be, and then choosing between alternative routes from here to there. Their specialty is the connection of past, present, and future. It is a specialty that makes a man a generalist. The reason for this ironical outcome is twofold. Each business enterprise is a moving, precarious, complex mix of people, materials, and techniques more or less efficiently organized to serve various group goals and, not so incidentally, varied personal needs. And to guide an enterprise is, first, to understand it: to know the whole and its parts in compound and unstable relationships.

Management and the Semirationalists

Such relationships are commonly subtle and hidden. They are "irrational," too, when judged by the usual standards of hardware technologists, industrial engineers, cost accountants, and "pure" economists. The standards and logics of these people are surely necessary to policy management and enterprise performance. But they are not sufficient, and single-minded devotees are at best semirational planners and managers. These standards and logics do not encompass or accommodate the "socio-psycho-logic" facts of the business enterprise, or, for that matter, of any other managed enterprise. Nor can they be sufficient, even where highly automated decisions guide highly automated processes. Wherever human beings are implicated—and they are, someplace, sometime, on this planet—human factors intrude upon the best-laid plans of the semirationalists.

Management is the organizing, coordinating, evaluating, and planning of the elements of productive enterprise (money, material, equipment, and people) toward the economic achievement of chosen objectives. Economy in the pursuit of objectives entails rationality, and, indeed, the history of management can be written in terms of changing and expanding ideas and methods of rational analysis and action. As Max Weber noted, rational mobilization of human resources on a large scale began with the ancient armies of the Romans and Egyptians. With the advent of mechanization and the factory system, the rationally planned bureaucratic form of organization found its way into enterprises of business as it had already done in government. Management increasingly came to be based on written documents—officials being designated to file and handle the documents, bureau by bureau, office by office. Managers worked full time, were specially trained and indoctrinated, and they followed general rules applicable to general categories of events. Authority was graded to insure clear arrangements of supervision and responsibility. During the eighteenth and nineteenth centuries, the manager came into his own. His job was a permanent vocation, a career along secure and predictable lines for which he had been specially trained and from which certain prestige was derivable.

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[*] Prepared by Nicholas J. Demerath, director of Social Science Institute, Washington University, St. Louis.

Workers, traditionally, were available and replaceable, and skill levels were rarely high. Rationality in the use of human resources could be restricted to such considerations as "How many workers?" "How long?" "How low a wage?" But, as the history of every industrializing nation has shown, worker protest developed against the inhumanities of mechanization and exploitation. These protests of workers coincided with the welfare objectives and political interests of rising elites and reformers. The protests were reinforced, too, by the greater sensitivity to human needs and behaviors of the more advanced technology. It was during World War I that management first used considerable psychological research. This dealt with personnel selection, classification, and training. Aptitude tests and measurements proliferated at a great rate. Managerial rationality had now extended to the consideration of data on human capacities, to one dimension of human behavior. Later, however, in the 1920's, labor difficulties began to reveal problems of worker motivation, loyalty, and supervision that could not be reduced to aptitudes and intelligence quotients. These were matters of person-to-person, group-to-group relationships; matters of cultural norms, communication, perception, motivation. Following leads from European psychology and certain sociological notions, Elton Mayo and his colleagues discovered "the informal group in the managed enterprise." The classic Western Electric research and the useful work by many behavioral scientists in World War II have served to open a new vista, a new extension of managerial reason—that of the "irrational," human emotion, perception, and behavior.

Behaviors of Management Relevance

More particularly, we may ask: What areas or aspects of human behavior possess special relevance for managers? I think there are five of these with quite clear management implications. *First* is demographic behavior; people are born, age, live, reside, move, and die on the surface of the earth and in relation to human institutions and natural resources. Demographic behavior is of particular significance to analysts and managers of marketing, of industrial or store location, and so on. *Second* is consumer behavior: the spending, saving, and investment patterns in the economy and market place as related to education, income, occupation, styles of life, cultural backgrounds, class aspiration, biosocial drives and needs, habits, and symbols. This is one of the most highly developed of all research areas, particularly for marketing and product design. *Third* is production behavior involving questions of aptitude and attitude, which we have noted above; of group formation and human relations as these affect output and costs. *Fourth* is political and power behavior, in the managed enterprise and in its relation to government, other business firms, and so on. Voting behavior in democratic societies is now widely researched, but is not particularly relevant in large parts of the world. Questions of mood, of general value and religious orientation, are involved here. On the management side, political-behavior analysis is fundamental to much of public relations and public information, and, as we shall emphasize later, to policy making generally. *Fifth,* and last, is management behavior. Here I refer to the actions of organization members as they affect and give substance to management processes—organizing, coordinating, directing, evaluating, planning, and forecasting. Here are questions of goal setting, of the allocation of resources, of structuring human resources so as to utilize economic and material elements. Here are the human coefficients of planning, policy, and evaluation. Here are the questions of motivation and learning, of "generalist" versus "specialist."[1]

To extend the rational scope of management in the service of human needs and goals is the way toward business management's emergence as a true profession, in contrast with the quick, ill-founded claims for such status. To do this is a challenge to thoughtful management and management students, particularly the behavioral scientists.

The cases in this book offer ample food for such thought, and full illustration of the challenge. They come out of businesses at different stages —manufacturing, wholesaling, retailing—and of different types—oil, insurance, electronics, food products, marble, metals, and so on. These businesses differ in organizational form and size, ranging from the one-owner, one-boss enterprise to the corporate giant with numerous subsidiaries and international activities. There are problems of growth, merger, personnel, accounting, finance, public controls, merchandising, supervision, and so on; and throughout, there are problems of decision and policy. The managers, owners, workers, and clienteles—our *dramatis personae*— represent a wide range of human types and social backgrounds. Thus, the cases constitute a slice of life for the professional manager and student.

Unlike some other authors and editors of case books, ours have not followed the foolish dictum "The facts speak for themselves." Instead, they have arranged the cases, by predominant features, under four major concepts of management: plan, organize and activate, control, and evaluate. And they have provided two grids on which the policy problems can be projected so as to highlight the pertinent management processes and human factors. In so doing, the editors have pointed the way to more detailed analysis and solutions by you students and teachers, the readers. My job, I take it, is to describe some general ideas and findings from behavioral science that, hopefully, will be of utility in your policy studies and policy making.

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[1] For critical summaries of research on our second, third, and fourth areas of behavior, see R. A. Dahl, M. Haire, and P. F. Lazarsfeld *Social Research on Business* (New York: Columbia University Press, 1959).

FIVE IDEAS FOR POLICY MAKING

I offer five main ideas for your consideration and use. They are ideas whose factual underpinnings I know something about, either from the inquiries of others or from my own research. They pertain to common problems of business policy, and together they are meant to outline a view or approach to policy study in some of its behavioral dimensions. In combination, the ideas and the approach are summarized thus:

1. Business policies are social decisions made in and for organizations. Knowledge of the processes and politics of decision are preconditions, usually, of effective policy.
2. Organizations must trade and exchange with their environments, and the goals that guide these exchanges are fundamental policy matters.
3. Human energies are directed, hopefully, toward organizational goals by many policies and panaceas, often with results not predicted by managers.
4. As has been demonstrated in both laboratory and field studies, the behavior of immediate supervision affects in predictable fashion the outputs of workers.
5. There are, generally speaking, two major prototypes or models of supervision, policy making, authority, and organization—the Traditional and the Neo-Scientific. The latter is more adequate, presumably, but how to adjust and apply it in specific situations is a complex question of great practical significance.

1. POLICY DECISIONS: *Business policies are social decisions made in and for organizations. Knowledge of the processes and politics of decision are preconditions, usually, of effective policy.*

Policies, of course, may be written or unwritten, and they will differ widely in the degree to which they merely project an existing state of affairs, or prescribe a future situation yet to be realized. They are to be distinguished from informational statements, and from instructions that specify how particular jobs are to be done. Policies are statements of goals and objectives of a general nature. They may also be more particularized statements of norms designed to implement or specify general objectives: statements that this or that should be done or not done. Less general policies may resemble procedures or informational messages. And what is policy to one group may not be to another. Zones of acceptance may vary widely through an organization, as may zones of indifference and outright rejection. Many a manager has issued a procedural regulation or instruction that seemed inoffensive, only to find his associates or subordinates to be outraged, their norms having been violated. Policy acceptance is a component of acceptable authority and a prime determinant of policy effectiveness.

Though individuals continually make policies for themselves—sorting or setting goals or norms to guide their own behavior—we refer here to the policies of organizations. Their determination is a principal task of management, with sources in organizational experience and broader expertise. It is sometimes the case that one man can set organizational policies. But even then he must usually reach back into his own history, or across to his contemporaries, for the value and knowledge he requires. One-man policy making in any enterprise with more than two persons is hazardous. And the more complex and specialized the business activities, the more hazardous is one-man policy making. As students of politics frequently observe, absolute dictators must at least seek advice from a few immediate subordinates, whose loyalty or judgment they must count on. The degree to which subordinates can and do participate in policy decisions by top management has been a theme of recent studies by management scientists.

For most policy decisions, a process in which a variety of people and groups interact can be observed, although information on these decisional processes is seldom presented in business cases. Sociologists and other administrative behaviorists have begun to pay more attention to processes of decision. Frequently, they distinguished such "phases" as these: (1) the occasion or problem for decision, (2) the analysis of the problem, (3) the identification of action alternatives, (4) the assessment of and choice among the alternatives, and (5) the implementation or administration of the decision. Policy making and policy decision are typically the more explicit, systematic, and "in the open" as management is the more professionalized. Special offices, branches, and divisions are set up to review performance and to spot policy needs, to make analytic studies, and to formulate alternative "positions." Thus we see plans officers, budget sections, operations-analysis groups, management-audit parties, outside consultants, and designated executive teams with these and other policy-making assignments. At the same time, considerable flexibility and informality may be preserved so that the policy machinery can handle the "political" necessities to be elaborated below.

The processes of decisional interaction from which policies emerge, transmit and sift communications of fact, opinions, and judgments. Astride these processes and channels are the gatekeepers, the secretive ones, those who are privileged and others who are not, those who know and those who are ignorant. Accordingly, personality factors, power, and authority enter the policy picture. Plans and policies made in social vacuums or contrary to such factors usually come to nought—as do the managers who make them. Frequently, it is the wise manager who is content to let policy be "made" by the daily decisions and actions of his rank and file. In any case, the prudent policy maker will know the powers and persons to reckon with and work with.

Such practical considerations in policy making can be guided by an idea or view of the firm or enterprise as an organized system. "Organization" or "system" means that interdependence of parts and of "separate activities" is viewed as likely—the fact and degree of interconnectedness, however, remaining to be determined in actual cases. "System" means continuous change in a contest with nonchange. Forces making for innovation and reorganization contend naturally with forces of resistance and the established order. These forces are generated from both inside and outside the enterprise or system. What "in" and "out" are is no simple question. The managed system has boundaries that are "open"; it is more or less permeable by the influence, claims, and limits of its varied environments. Between "in" and "out" there are exchanges of outputs for inputs, of products and services for manpower, money, and materials.

Managed systems are composed of subsystems or part-systems. What is to be defined as the part-system relevant to a given policy problem is rather arbitrary. It may be no more than a single employee and his supervisor in a man-to-man relationship, or it may be as extensive and complex as the management of a giant corporation, union, or industry seeking a *modus vivendi* with the government of a nation. The part-system of problem relevance—the elements to be included and their estimated relationships—cannot be identified until the analyst has made some diagnosis, however rough and tentative, of the problem and some alternative solutions. Hidden connections and unexpected consequences in human-behavior terms merit uncovering and anticipating. Technological problems have a habit of turning into human problems of motivation and leadership. Profit difficulties may be traced to shop waste, and then to poor personnel practices, and so on. And one man's perspective and information may be less reliable and more limited than others'. Policy-problem analysis is never easy, and is commonly done badly.

Policy inquiry does not come easily for many managers. They may not be capable of dispassionate studies when passionate action is their stock-in-trade. Or, being specialists, they may not see generally and broadly into the system's ramifications. The best policy decisions are apt to employ the method of science—the rational ordering and interpretation of verifiable facts—combined with the normative considerations of a profession, essentially the same method we see in medicine, engineering, and the law. The sequence of observation, diagnosis, and prognosis grounded in outcomes judged more or less desirable is the essence. It is this sequence that calls upon and nurtures a management science—a science that draws, in turn, upon many scholarly and scientific disciplines and that is prerequisite to the art and practice of management. The art itself is also a matter of serial observation, correction, and perfection in cooperation with the scholar. Such cooperation is indispensable to the advancement of management in both its scientific-analytic and its art-interventionist aspects.

In recent years, some behavioral scientists, particularly those preoccupied with organization analysis, have devoted much attention to decision making. As Robert Dubin has noted,[2] their concerns have been quite mechanical and formal since high-speed computers have made possible more and more rapid examination of the results of alternative decisions. Fortunately, some other investigators have studied decisional behavior firsthand, with results that serve to amplify, indeed to correct, the mechanistic studies using computer simulation models of decisional activities.

Policy decisions are political processes as well as intellectual and technical affairs. And they take time, much more time than mechanists or semirationalists might think. Indeed, "the greater the need to accommodate differences in a decision, the more time may be consumed in reaching the decision."[3] To the point that policy decisions tend to take a very much longer time than we may imagine, Dubin summarizes a publication by Cyert, Simon, and Trow, reporting the history of a decision on the installation of eclectronic data processing.

> The fascinating aspect of this study is that this highly rational decision about a highly rational method in business operations was initiated in July, 1952, and the recommendation to the board of directors was not made until the middle of February, 1956. There was an actual lapse of *three and three quarters years* before a plan was hardened to the point where it could be presented for a "yes or no" decision by the board of directors. Cyert, Dill, and March (19) covered the same case again and added to it the history of two other decisions. In one company the safety hazard of overhead cranes led to a consideration of their replacement by magnetically controlled cranes. After *two years* of investigation, discussion up and down the ranks of management, and formulation and reformulation of proposals, there was a committee recommendation that the cranes be replaced. After all this very considerable work and thought and discussion, the recommendation was turned down, and the old policy was continued of making single replacements as individual cranes wore out. Note that both these problems involved rather simple, single issues—and note the time scale over which each decision was under active consideration.[4]

Dubin goes on to report comparable findings in the cases of policy decisions in a telephone company dealing with the transfer of employees within the company; of general management policy making in an English metal company; and of a study of industrial-relations policy decisions in 135 companies.

Regarding the political nature of policy decision processes, Dubin notes that one consequence of the long time taken in reaching policy decisions is that there is opportunity provided thereby for the working out of the political factor in decision making. That is to say, "disparate interests and even conflicting interests of individuals or groups are accommodated in the decision itself. These differences first have to be searched out through discussion and analysis, the disparities among them made clear, and the points of compromise and accommodation determined. Finally, the actual decision incorporating the balance points among the interests has to be reached. These steps taken together involve political process."[5] Melville Dalton's book, *Men Who Manage*, which he describes as "an analytical record of interplays between compromising situations and compromising managers in commercial and industrial settings," is rich with observations of the politics of policy making.[6]

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[2] Robert Dubin *et al., Social Science Approaches to Business Behavior* (Homewood, Ill.: The Dorsey Press, Inc., and Richard D. Irwin, Inc., 1962), p. 30.

[3] *Ibid.,* p. 34.

[4] *Ibid.,* p. 31.

2. ENVIRONMENT: *Organizations must trade and exchange with their environments, and the goals that guide these exchanges are fundamental policy matters.*

Sociologists have paid much less attention to external or environmental relations than they have to behavior "inside" the managed enterprise.[7] Policy students and policy makers, on the other hand, are so much concerned with the management of environmental relations that it behooves us to say what we can of this critical area. We start with the view that organizations must trade and exchange with their environments to get established, to grow, or to survive. Even when management seeks to go out of business, to end their organization, they weigh the loss-gain balance in the process of decision; and the consent of another organization may be required to terminate one's "own firm."

The relationships between an organization and its environment provide for and are shaped by these exchanges. Exchanges, in turn, are matters of basic policy decisions—"basic" referring to the setting, revision, and reinterpretation of the goals that are to be pursued by the organization in its environment. From these goals or objectives there will follow many—though not all—policy decisions on production and technology, financing, marketing, advertising, personnel, and so on. The goals of all commercial banks may look alike. So, for example, may the goals of all automobile dealers, all fertilizer manufacturers, all liberal arts colleges, all military units of a type, and so on. But such similarities appear only at a distance or in ignorance of behavioral realities.

Let me give one behavioral reality for illustration. Two hardware retailers competed on equal terms for the trade of a suburban "do-it-yourself" clientele. One carried a single line of house paints because the owner's brother was the paint manufacturer and the family tie was strong. The other store carried that line and three others. A consumers' advisory service that was read by some opinion makers in the suburb tested house paints and reported that the paints made by the storeowner's brother were distinctly inferior to certain other brands, two of which were stocked by the second store. The first store would not take on another line of paint, and its market position deteriorated in house paints and other wares in competition with the rival retailer. More and more potential customers also learned of the brother relation between supplier and retailer; they felt "monopolized," and so they shopped at the second store for this reason, also. The environment relation was not suited to the profit objective of the first store, and the family factor precluded any revision.

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[5] *Ibid.*, p. 33.

[6] Melville Dalton, *Men Who Manage* (New York: John Wiley & Sons, Inc., 1959).

[7] W. H. Form and D. C. Miller, *Industry, Labor, and Community* (New York: Harper & Bros., 1960), contains a good review of much of the pertinent research.

Wise policy managers do not have to read sociological theory to know that environment goals should be frequently reexamined and, possibly, revised. Professor Ike H. Harrison, of Texas Christian University, tells the story of the new president of a large railroad at his first meeting of the board of directors. The president posed the question "What is our business?" The board members, taken aback, replied, "Railroading—didn't you know?" At the end of the meeting, several hours later, the major goal was revised to "transportation," and this was interpreted to include the transport of natural gas through pipe lines to be built by the company along its right of way from Texas fields to markets in the Midwest and on the Pacific coast. The company prospered, beginning with a goal review and revision.

Thompson and McEwen, in an important theoretical paper,[8] note that the necessary interaction between an organization and its environment entails an element of control of the organization by its environment. This is the price of profitable or favorable exchange. One can imagine a range of organizational power over environment all the way from the extreme in which the enterprise dominates its environmental relations to the other extreme, where the organization is completely dominated by its environment. As Thompson and McEwen note, very few organizations approach either extreme. The *Zaibatsu*, in Japan, or the old Standard Oil Trust, in America, have approached the dominance over environment position, but this brought about "countervailing powers." The commuter bus and rail lines and, more recently, certain airlines are the nearest approximation to the completely powerless organization. Their facilities and services are essential. The society, through its government, will not allow them to quit easily, and will subsidize them to establish them or keep them operating. Most organizations, falling between the extremes of the power range, must adopt strategies for coming to terms with their environments. These strategies are not necessarily chosen by rational or deliberate process, but the adjustment is in itself a factor in organizational prosperity.

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[8] James D. Thompson and William J. McEwen, "Organizational Goals and Environment," *American Sociological Review*, Vol. XXIII (1958), pp. 23–31; reprinted in part in Amitai Etzioni (ed.), *Complex Organizations* (New York: Holt, Rinehart and Winston, 1961).

Thompson and McEwen classify and describe the strategies for dealing with environment—and correspondingly, policy strategies, in our terms—as either *competitive* or *cooperative*. The cooperative strategy, they think, may be further differentiated into three varieties: *bargaining*, *co-optation*, and *coalition*. Now let us look at these strategies, as they are described by Thompson and McEwen, very briefly:

> The term "*competition*" [emphasis mine] implies an element of rivalry. For present purposes competition refers to that form of rivalry between two or more organizations which is mediated by a third party. In the case of the manufacturing firm the third party may be the customer, the supplier, the potential or present member of the labor force, or others. In the case of the governmental bureau, the third party through whom competition takes place may be the legislative committee, the budget bureau, or the chief executive, as well as potential clientele and potential members of the bureau.
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> . . . .
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> Competition is thus a complicated network of relationships. It includes scrambling for resources as well as for customers or clients, and in a complex society it includes rivalry for potential members and their loyalties. In each case a third party makes a choice among alternatives, two or more organizations attempt to influence that choice through some type of "appeal" or offering, and choice by the third party is a "vote" of support for one of the competing organizations and a denial of support to the others involved.
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> . . . .
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> The term *bargaining* [emphasis mine], as used here, refers to the negotiation of an agreement for the exchange of goods or services between two or more organizations. Even where fairly stable and dependable expectations have been built up with important elements of the organizational environment—with suppliers, distributors, legislators, workers and so on—the organization cannot assume that these relationships will continue. Periodic review of these relationships must be accomplished, and an important means for this is bargaining whereby each organization, through negotiation, arrives at a decision about future behavior satisfactory to the others involved.
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> The need for periodic adjustment of relationships is demonstrated most dramatically in collective bargaining between labor and industrial management, in which the bases for continued support by organization members are reviewed. But bargaining occurs in other important, if less dramatic, areas of organizational endeavor. The business firm must bargain with its agents or distributors, and while this may appear at times to be one-sided and hence not much of a bargain, still even a long-standing agency agreement may be severed by competitive offers unless the agent's level of satisfaction is maintained through periodic review. Where suppliers are required to install new equipment to handle the peculiar demands of an organization, bargaining between the two is not unusual.
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> . . . .
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> *Co-optation* [emphasis mine] has been defined as the process of absorbing new elements into the leadership or policy-determining structure of an organi-

zation, as a means of averting threats to its stability or existence.* Co-optation makes still further inroads on the process of deciding goals; not only must the final choice be acceptable to the co-opted party or organization, but to the extent that co-optation is effective it places the representative of an "outsider" in a position to determine the occasion for a goal decision, to participate in analyzing the existing situation, to suggest alternatives and to take part in the deliberation of consequences.

The term "co-optation" has only recently been given currency in this country, but the phenomenon it describes is neither new nor unimportant. The acceptance on a corporation's board of directors of representatives of banks or other financial institutions is a time-honored custom among firms that have large financial obligations or that may in the future want access to financial resources. The state university may find it expedient (if not mandatory) to place legislators on its board of trustees, and the endowed college may find that whereas the honorary degree brings forth a token gift, membership on the board may result in a more substantial bequest. The local medical society often plays a decisive role in hospital goal-setting, since the support of professional medical practitioners is urgently necessary for the hospital.

From the standpoint of society, however, co-optation is more than an expediency. By giving a potential supporter a position of power and often of responsibility in the organization, the organization gains his awareness and understanding of the problems it faces. A business advisory council may be an effective educational device for a government, and a White House conference on education may mobilize "grass roots" support in a thousand localities, both by focussing attention on the problem area and by giving key people a sense of participation in goal deliberation.

. . . .

As used here, the term *coalition* [emphasis mine] refers to a combination of two or more organizations for a common purpose. [Merger as these authors define it, is a permanent fusion of two or more organizations.] Coalition appears to be the ultimate or extreme form of environmental conditioning of organizational goals. . . . A coalition may be unstable, but to the extent that it is operative, two or more organizations act as one with respect to certain goals. Coalition is a means widely used when two or more enterprises wish to pursue a goal calling for more support, especially for more resources, than any one of them is able to marshall unaided. American business firms frequently resort to coalition for purposes of research or product promotion and for the construction of such gigantic facilities as dams or atomic reactors.

. . . .

Coalition requires a commitment for joint decision of future activities and thus places limits on unilateral or arbitrary decisions. Furthermore, inability of an organization to find partners in a coalition venture automatically prevents pursuit of that objective, and is therefore also a form of social control. If the collective judgment is that a proposal is unworkable, a possible disaster may be escaped and unproductive allocation of resources avoided.[9]

3. Energies: *Human energies are directed, hopefully, toward organizational goals by many policies and panaceas, often with results not predicted by management.*

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* Philip Selznick, *TVA and the Grass Roots* (Berkeley and Los Angeles: University of California Press, 1949). (Footnote 7 in original.)

[9] Thompson and McEwen, in Etzioni, *op. cit.*, pp. 181–86, in part.

It is a trite dictum of countless speeches and textbooks that the ultimate management challenge is the harnessing of human energies. What does this mean? Seemingly, it is a self-evident truth. Managers may create the "perfect" organization by plan, by law, by technology, by formality, but—as our editors remind us—unless the organization is "activated" there is no performance, productivity, or exchange. This is all right as far as it goes, but, you may well ask, just how does one harness human energies? As is the case for many such truths, self-evidence here is not sufficient evidence, and the verifiable facts and established principles of useful knowledge are thin and spotty. Despite the best-made policies on industrial relations, on wages, on personnel selection, classification, training, and promotion, on management development, on communications, and on organization, the unpredictable element is uncommonly large. More than 30 to 50 percent of human energies—the estimates vary—remain untapped in our managed enterprises. And some students argue that it is better to let social nature take its course, spontaneously—unprescribed except by minimal official plan and policy.

Managers have had to act on faith, and there have been many faiths; for example, profit sharing, corporate community, time and motion, participative management, wage and incentive schemes, rest schemes, health schemes, nutritional formulas, fringe benefits, piped-in music, piped-up suggestions, even worker ownership. Of all the faiths in recent years, that of human relations—the movement and cult—has perhaps enjoyed the greatest vogue. As a cult, it may be harmful to individuals and organizations, as one critic, pointing to its mystical and revolutionary qualities, has noted.[10] But human relations is not only a cult; it is also a line of research. Guided along more experimental lines, and with more attention to the intrinsic nature of jobs, work, and occupational norms, it promises useful knowledge of work groups and organizations. Generally, in our kind of society, human-relations research supports wider participation in decision making and less executive authority and supervision in the traditional manner. Parts IV and V, following, serve to illustrate this second aspect of human-relations study and practice, by means of an experimental study of supervision and job performance and a comparison of two prototypes of authority and organization. In the present section, attention is directed to research on worker protest and dissatisfaction, crude but practical indicators of less-than-optimum mobilization of energies.

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[10] William H. Knowles, "Human Relations in Industry: Research and Concepts," *California Management Review*, Vol. I (Fall, 1958); also published as Reprint No. 117 of the Institute of Industrial Relations, University of California at Berkeley, 1958, p. 102. Two other appraisals of the human-relations movement, the first dealing with ethical considerations and the second with the political and scientific criticisms of a seminal source, are: H. Baumgartel, "Notes on Some Criticisms of Human Relations," *Kansas Business Review*, Vol. XIV (November, 1961), pp. 8–10; H. A. Landsberger, *Hawthorne Revisited* (Ithaca, N.Y.: Cornell University Press, 1958).

In managing energies, one begins with the fact that behavior is motivated by varied biosocial needs or drives.[11] Some of these drives we are born with; others are acquired in the social life of family, class, school, community, and work. Most are complex compounds of inheritance, social background, and distinctive psychological experiences. In the work organization, a second fact emerges: management sets goals, jobs, and activities for the enterprise and seeks compliance from all concerned by various inducements. One inducement may be that goals and expectations are accommodated nicely and directly to the needs and capabilities present in the organization. More commonly, however, personal needs cannot be immediately or sufficiently met at work; their gratification must be put off. Under this circumstance, energies may be withheld and men may not be committed to job and organization demands as fully as management, or even the workers themselves, might like. Protests of various kinds can be expected.

Worker protest—and we do not exclude managers here—takes many forms, according to the nature of work, management, and worker relations. According to Kerr and his associates, the historical stage of a society's industrialization and management development entails a characteristic type of commitment by workers;[12] that is, the individual workers will see their personal needs in different relations to organization goals according to the stage of industrialization and correlative commitment. Kerr *et al* delineate four different stages of commitment and corresponding forms of protest, ranging down the list from primitive to advanced industrialization, as follows:

Stage of Commitment	*Characteristic Forms of Protest*
Uncommitted workers	Turnover, absenteeism, fighting, theft, sabotage.
Semicommitted workers	Spontaneous work stoppages, guerrilla strikes.
Committed workers	Plant and industry strikes and political protests and activity.
Specifically committed workers (technical)	Grievance machinery, labor courts, organizational, external, and occupational alliances, political party activity

Although the United States society is distinguished by an unusually large proportion of "specifically committed workers"—technicians and professionals—we see, nevertheless, considerable unevenness in their distribution by industry and by geographic area. Correspondingly, we also observe quite varied forms of protest, industry by industry, area by area. What factors are at work here, and on the world-wide historic scene to which Kerr and his colleagues address their attention? The sociologist is not content to stop with the statement that stage of industrialization is associated with stage of commitment and, hence, with characteristic forms of protest. A look at some studies of work satisfaction may provide us with some useful clues.

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[11] There are several classifications, several vocabularies, of motivation. One of the more adequate ones has been stated by A. H. Maslow, and is used by several management authors. Abraham H. Maslow, *Motivation and Personality* (New York: Harper & Bros., 1954). See also Douglas McGregor, *The Human Side of Enterprise* (New York: McGraw-Hill Book Co., Inc., 1960), pp. 35–43.

[12] Clark Kerr, J. T. Dunlop, F. Harbison, and C. A. Myers, *Industrialism and Industrial Man* (Cambridge, Mass.: Harvard University Press, 1960), pp. 202–8.

After a critical survey of recent studies of work satisfaction in the United States, Robert Blauner concluded that most workers, perhaps a very large majority, are moderately satisfied with their jobs, and that even when they do not find satisfaction overall in their immediate job, they find significant meaning in their work.[13] This is counter to the common notion that most workers in our society are dissatisfied and alienated. But then, intellectuals and executives do not find it easy to understand the work that is not theirs. The various studies leave a good deal to be desired in their methods, but the cumulative evidence is all in the same direction, and is difficult, therefore, to reject. Percentages dissatisfied range from 11 to 20; percentages satisfied, from 80 to 90. Sociologically, these findings are neither very surprising nor particularly interesting, for there is a natural tendency in "normal" times for people to view positively their existing social involvements: religion, family, marriage, nation, and job.

More revealing, probably, and certainly of much greater interest, theoretically and management-wise, are marked occupational differences in work satisfaction that Blauner finds in various surveys.[14] For example, one study produced a rank order of mean indexes of satisfaction on the part of jobholders in a Pennsylvania town as follows:

Occupational Group	*Mean Index*
Professional and managerial	560
Semiprofessional, business, and supervisory	548
Skilled manual and white collar	510
Semiskilled manual workers	483
Unskilled manual workers	401

A national survey produced a similar rank order when workers were asked whether they would continue the same line of work if they inherited enough money to live comfortably otherwise:

Occupational Group	*Persons Who Would Continue*
Professionals	68
Sales	59
Managers	55
Skilled manual	40
Service	33
Semiskilled operatives	32
Unskilled	16

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[13] Robert Blauner, "Work Satisfaction and Industrial Trends in Modern Society," in W. Galenson and S. M. Lipset (eds.), *Labor and Trade Unionism* (New York: John Wiley & Sons, Inc., 1960).

[14] *Ibid.*

Other results reproduced by Blauner show more professionals than nonprofessionals who said they would choose the same kind of work if they were starting over again. The percentages choosing the same career were, respectively:

Professionals		*Nonprofessionals*	
Mathematicians	91	Skilled printers	52
Physicists	89	Paper workers	52
Biologists	89	Skilled automobile workers	41
Chemists	86	Skilled steelworkers	41
Lawyers	83	Textile workers	31
Journalists	82	Unskilled steelworkers	21
		Unskilled automobile workers	16

Like the simple "How satisfied are you?" studies, the surveys of occupational-choice satisfaction show professionals, white collar workers, and blue collar workers ranked descendingly in that order in positive evaluation of their work. This is what we might expect on the basis of differences in conditions of work. Also, the interoccupational differences reflect differences in attitudes toward work and in norms—held both by workers and by their fellow citizens. As Blauner puts it:

> The professional is expected to be dedicated to his profession and have an intense intrinsic interest in his area of specialized competence; the white collar employee is expected to be "company" oriented and like his work; but the loyalty of the manual worker is never taken for granted and, more than any other occupational type, cultural norms permit him the privilege of griping.[15]

These normative and attitudinal differences reflected in work satisfactions may be attributed, in turn, to various fundamental elements in the nexus of work-person-society. Summarizing, in the main, Blauner's important delineations, these factors are:

a) *Occupational prestige:* Variations in work satisfaction among different occupations tend to follow variations in occupational prestige. Indeed, this is the one best explanatory factor, because it incorporates and is dependent upon such other factors as level of skill required by the job, income, degree of training or education, amount of control or responsibility involved. However, in some cases, other factors are more critical than prestige or status such as, for example, control and integrated work groups.

b) *Control:* Work involves a surrender of control, a subordination of the worker to more remote aims and organizational goals. The need for control and independence in work varies between societies, but seems particularly strong in the United States. The autonomy given is usually greatest at the top of managed organizations and least at the bottom, usually greatest for executive-planners and least for routinized blue collar workers and clerks. Control involves several dimensions—e.g., time, movement, technical environment, social environment, and freedom from hierarchical authority. Blauner generalizes: ". . . the greater the degree of control that a worker has (either in a single dimension or as a total composite) the greater his job satisfaction."[16]

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[15] *Ibid.*, p. 343.

[16] *Ibid.*, p. 343.

c) *Integrated work group:* The more that workers on the job belong to closely knit, primary ("informal," face-to-face) work groups, the higher the level of their job satisfaction. This general fact has been demonstrated many times, particularly by the human relationists, for whom the study of work groups has been a preoccupation entailing neglect of the intrinsic qualities of the job and technology and excessive concern with the phenomena of communication, leadership, "sensitivity," personality, and the like.

d) *Occupational communities:* Levels of work satisfaction are higher in those jobs and industries wherein workers comprise an occupational community—e.g., miners, sailors, cowboys, railroaders, aircraft crews, long distance truck drivers. Isolation spatially or by off-hours shifts often produces such communities of fellow workers.

What lessons can managers draw from these ideas and facts on worker protests and satisfactions? Certainly no one-to-one inferences can be drawn from the research materials to a specific management goal. Take, for example, labor-management harmony as a goal. The four nexus factors just described may all bulk large in a given organization. Work satisfactions, consequently, may be high all around. And yet—or perhaps because of high satisfactions and corresponding expectations—there may be strikes; the airlines on occasion seem to illustrate this point. Or take the enterprise with a critical component of talented, professional manpower (for example, scientists and engineers). Commitments to specialized areas of competence and dedication to professions may themselves lead to low energy outputs on organizational goals or to resignations and excessive turnover.[17]

Like so much of behavioral science applied to management, the worker-protest and work-satisfaction ideas and findings—meager as they are at present—should help managers think about their organizations, just as they should help investigators study phenomena of commitment and performance. The overall finding of general satisfaction among United States workers established by the few studies that have been made is not basis for contentedness with management-as-is. The findings that workers want to be masters of their job destiny and that loss of control evokes strong dissatisfaction are equally important. What is called "colleague management," and the expansion of control through job enlargement and job rotation, merit serious consideration by many managements, it seems.[18]

4. OUTPUT: *As has been demonstrated in both laboratory and field studies, the behavior of immediate supervisors affects in predictable fashion the outputs of workers.*

In one sense, all of management is pointed to output, but it is the immediate or "first-line" supervisor of the production workers, whether in office or shop, who is most directly influential. Like Army sergeants and Navy chiefs, the foremen and other bosses of small work groups in business are powerful figures in organizational performance. It is not surprising, therefore, that the supervisor's role as an output factor has attracted a good deal of research. Let us review some of this research, and also summarize an exemplary experiment, as yet unpublished, that was designed to test some prior findings.

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[17] Peter M. Blau and W. R. Scott, *Formal Organizations* (San Francisco: Chandler Publishing Co., 1962), pp. 60–74, offers an excellent discussion bearing on the management of professional personnel.

[18] C. R. Walker and R. H. Guest, *Man on the Assembly Line* (Cambridge, Mass.: Harvard University Press, 1952).

The classic Western Electric studies, reported in *Management and the Worker,* by Roethlisberger and Dickson, were among the first to present different supervisory behaviors systematically observed and linked to output. There we began to see the distinction between "people centered" and "task centered" supervision. R. Freed Bales then demonstrated differing leadership roles paralleling the Western Electric comparison; the integrative leader and the instrumental leader. Work by Daniel Katz and his associates at the Michigan Survey Research Center, by A. L. Comrey *et al.,* by Alvin Gouldner, and by others engaged in field studies in industrial settings, isolated two especially important variables of supervisory behavior: closeness of supervision and punitiveness exercised by the supervisor. The researches were done in a variety of work settings: office workers in a large insurance company, factory workers in a tractor plant, factory workers in a gypsum plant, and construction gangs on a railroad.[19]

From this research there came *the general proposition* that close and punitive supervision relate positively to tensions among the supervised workers, and relate negatively to productivity. This was noted by Robert Day, a doctoral student in sociology at Washington University. His methodology and findings deal with the fundamental problem, that of supervision. His study shows the kind of research that can be done to build an honest-to-goodness management science. While this is an "exemplary experiment," it is interesting because of its intellectual roots, its practical payoff, and its methodology. He reasoned further that tensions provoked by close and punitive supervision would get expressed not only (1) toward the supervisors themselves, but, indirectly, (2) toward fellow workers and (3) toward the task at hand. Psychologically, this would be a phenomenon of "displacement." And Day thought that it should be tested as part of a theory of supervisor-worker tensions and productivity. Day also wanted to test the influence of different personality attributes of workers. These, he thought, might well influence perceptions of the workers and, correspondingly, their responses to close or punitive supervision. In particular, Day decided to examine each worker's need to control his own interpersonal relations along with—another personality variable—each worker's self-esteem. Although he obtained dependable measures by these personality variables, on only the latter, self-esteem, did he get significant results, as we shall see.

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[19] F. J. Roethlisberger and W. J. Dickson, *Management and the Workers* (Cambridge, Mass.: Harvard University Press, 1947); R. L. Kahn and D. Katz, "Leadership Practices in Relation to Productivity and Morale," in D. Cartwright and A. Zander (eds.), *Group Dynamics: Research and Theory* (Evanston, Ill.: Row, Peterson and Co., 1953); A. L. Comrey, J. M. Pfiffner, W. S. High, *Factors Influencing Organizational Effectiveness* (Los Angeles: University of Southern California, 1954), mimeo.; A. W. Gouldner, *Patterns of Industrial Bureaucracy* (Glencoe, Ill.: Free Press of Glencoe, Inc., 1954); T. Parsons, R. F. Bales, and E. A. Shils, *Working Papers in the Theory of Action* (Glencoe, Ill.: Free Press of Glencoe, Inc., 1953).

What was Day's *experimental procedure?* He composed 24 groups of four subjects. The subjects were college-age females, and the task he gave them was the assembling of simple models by following blueprint layouts. These groups were assigned randomly to four "treatments," that is, the experimental stimuli. Confederates, or "stooges," were trained to enact four supervisory roles compatible with 4-by-4 factorial design. Closeness of supervision was low where 8 task instructions were given, and it was high where 40 were given. Carefully controlled instructions to the subjects kept closeness distinct from punitivity. In the "closeness alone" cases, instructions were given in neutral, nonpunitive voice and mood. Any nonverbal cues—facial expressions, and so on—that might otherwise have crept into the supervisor's behavior were also controlled. On the punitivity line, sarcastic and status-deflating remarks were made by the supervisors, 40 of them in the high case and none in the low. Task performance was a matter of counting the number of models completed. Tension of the workers was measured by trained observers, whose reports were coded and analyzed. A postexperiment questionnaire completed by the workers recorded the interpersonal tensions they felt toward the supervisor, their co-workers, and the model-building task. Self-esteem and the desire to control interpersonal relations were measured by a brief questionnaire given before the experiment. The task, it should be noted, was suited to an assembly-line procedure, and was selected because it lent itself easily to measurement of group productivity.

The results of Day's experiment show that close supervision produced a significant increase in tension felt toward the supervisor. Verbally expressed tension toward the supervisor, however, increased only *in*significantly, and tension toward co-workers did not quite achieve statistical significance. Punitive supervision produced a significant increase in tensions toward the supervisor. These were expressed both verbally and in the questionnaire. There were no increases of significance in tensions felt by workers toward their fellows or toward the task. That is, the anticipated displacement of tension did not occur; the supervisor was the exclusive object of the workers' tension emotions. The most impressive result was that under *both* close and punitive supervision, productivity was significantly lowered—more than with either attribute alone.

Another finding, original in Day's work, is that self-esteem turned out to be a mediating factor; that is, worker tensions were increased more or were greater with low self-esteem than with high. This last finding was in accord with Day's reasoning, based on a theory of Irving Goffman that

". . . individuals having secure, favorable self images, that is, possessing high self-esteem, would be relatively unconcerned with 'impression management,' while persons who lack such confidence, possessing low self-esteem, would be highly concerned with impression management. . . . Under close or punitive supervision, subordinate workers, possessing low self-esteem would develop relatively high tensions toward the supervisor."[20]

It is to be noted that Day's experiment, like the work of his predecessors, dealt with routine work by semiskilled or unskilled workers. By experimental procedures, Day demonstrated, in the case of his 24 four-person groups, that closeness and punitivity of supervision *cause* lowered productivity through increased worker tensions felt toward their supervisors. If this be true of routinized work by unskilled or semiskilled people, would it not be true of skilled jobs involving talented manpower? I think it would, and in even greater degree, especially where creativity is expected on the job. That is, in research laboratories, certain engineering and development activities, planning staffs, and the like, I would expect then more effective supervision to be comparatively loose, nonpunitive, and person-oriented. What else though, might be required for optimum productivity? In both routinized-low-skilled and creative-high-skilled situations, recent research shows that well-liked supervisors and satisfied workers do not necessarily guarantee optimum output. More generally speaking, it is known that productivity and "morale"—fuzzy word that it is—do not always vary together. Productivity may be achieved without satisfaction and without well-liked supervisors because the planning, engineering, or technical management is good; because career aspirations or personal norms of workers make them productive in spite of the work situation; because "morale" or "satisfaction" are inaccurately measured, or contain variables that fluctuate independently.[21]

Such questions and surmises as those above gain importance as our economy continues to industrialize, to automate, and to depend increasingly on scientific and talented manpower. With the experimental study and these inferences and questions in mind, we turn to the next and last social-management idea—social in derivation and social in implementation.

5. MANAGEMENT MODELS: *There are, generally speaking, two major prototypes or models of supervision, policy making, authority, and organization—the Traditional and the Neo-Scientific. The latter is more*

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[20] From the dissertation abstract, Robert C. Day, "Some Effects of Closeness and Punitivity on Supervision" (Washington University, 1962).

[21] A good synthesis and critique of research and of management thought on morale, output, satisfaction, and supervision may be found in Charles B. Spaulding, *An Introduction to Industrial Sociology* (San Francisco: Chandler Publishing Co., 1961), pp. 214–88. See also John J. Thibaut and Harold H. Kelly, *The Social Psychology of Groups* (New York: John Barley & Sons, 1959); and Ralph M. Stogdill, *Individual Behavior and Group Achievement* (New York: Oxford University Press, Inc., 1959).

adequate, presumably, but how to adapt and apply it in specific situations is a complex question of great practical significance.

In recent years, a number of behavioral scientists and management students have constructed new "theories" of management and managed organization. "Model" or "prototype," I think, are better words for these constructs, because they are not explanatory in a scientific sense as much as they are utilitarian devices for practical purposes. Nor are they models for research purposes, as are, for example, Gouldner's "rational" and "natural system" models—even though it is the comparison of these by means of sociological analysis along natural system lines that lends itself to the constructs we will consider.[22] Be that as it may, the prototypes we will consider are in each instance adduced from behavioral research, though the derivations are sometimes quite general and impressionistic. And in as much as they come out of modern behavioral science research and not the older management science, I call them Neo-Scientific. In each case also, the new model is contrasted with an older belief, "theory," or model—the Traditional ones. For literary reasons, I will present *the* Traditional and *the* Neo-Scientific models, as though there were only two. In fact, there are several in each category, of course, and I do not presume to be familiar with all of them.

The authors and concepts I will draw upon and, hopefully, draw together are categorized and cited below, listed simply by alphabetical order of authors.

SOME RECENT MANAGEMENT MODELS AND THEIR AUTHORS*

Author's Name	*Name of Neo-Scientific Prototype*	*Name of Traditional Prototype*
Chris Argyris	Good Organization	Not-Good Organization
Simon Marcson	Colleague	Executive
Douglas McGregor	Theory Y	Theory X
Carl R. Rogers	Psychologically Safe and Free	Psychologically Not-Safe and Not-Free
Herbert A. Shepard	New Direction	Traditional Theory
Charles B. Spalding	General Design for Harmonious Productivity	Authoritarian Bureaucracy

* Chris Argyris, "The Integration of the Individual and the Organization," *Some Social Science Approaches to Business Behavior*, *op. cit.*, pp. 65–70; Simon Marcson, *The Scientist in American Industry* (Princeton, N.J.: Princeton University, Industrial Relations Section, 1960), pp. 121–41; Douglas McGregor, "The Human Side of Enterprise," A. H. Rubinstein and C. J. Haberstroh (eds.), *Some Theories of Organization* (Homewood, Ill.: The Dorsey Press, Inc., and Richard D. Irwin, Inc., 1960), pp. 177–87; Carl R. Rogers, "Toward a Theory of Creativity," H. H. Anderson (ed.), *Creativity and Its Cultivation* (New York: Harper & Bros., 1959), pp. 78–80; H. A. Shepard, as reprinted in Rubenstein and Haberstroh, *op. cit.*, pp. 8–9; Spaulding, *op. cit.*, pp. 233–38.

The general structure of a Neo-Scientific Model, its patterns of authority and communications, has been most completely and succinctly outlined by Spaulding.[23] It is reproduced here, element by element.

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[22] A. W. Gouldner, "Organizational Analysis," in R. K. Merton, L. Broom, and L. S. Cottrell, Jr. (eds.), *Sociology Today* (New York: Basic Books, Inc., 1959).

[23] Spaulding, *op. cit.*, pp. 286–87.

1. Wages, working conditions, and fringe benefits which compare favorably with others in the community or industry.
2. Clear job definitions and initial instruction.
3. Opportunities for group formation.
4. Participation (in setting objectives) by workers treated as intelligent adults.
5. Foremen who can plan, are interested in the welfare of their workers, are reasonably permissive, are skilled in the work, and fit the workers' stereotype of a foreman.
6. Clear lines of authority and clear staff roles.
7. Considerate discipline by line personnel.
8. Personal contacts with employees by middle managers but use of the full line when authority is exercised.
9. Support for the foreman's approach by higher echelons.
10. A feeling of security in the workers concerning their employment and concerning the reactions of management.
11. A free flow of information along both formal and informal channels.
12. Coordination through a carefully defined but honest use of committees.
13. The preservation of the foreman's role, reduction of the number of levels in the hierarchy, and decentralization.

By inference from the 13 elements, the general structure of the Traditional Model can be deduced. That is, to the extent that one or more of the 13 are missing from a managed organization, it can be said to be Traditional. In actuality, of course, few, if any, organizations are all Neo-Scientific or Traditional.

The authors cited, in addition to characterizing and comparing the elements and forms of the old and new models, contrast approach and viewpoints of top management devotees, especially their views of "human nature." The Traditional approach sees management as a process of directing manpower efforts, of motivating people and modifying their behavior to fit the needs of the organization. To these ends, management actively intervenes, because without such intervention people are believed to be indifferent, even resistant, to the organization's goals. Consequently, it takes a "carrot and stick" psychology to mobilize and motivate average people, who are thought to be "naturally" lacking in ambition, indolent, resistant to change, self-centered, and gullible; who are thought to dislike responsibility and to prefer to be led. Management intervenes on the basis of authority given by administrative charter and regulations. The Traditional executive and supervisor issues orders and directives without much consideration of the views of his subordinates, except when needed to gain their consent. He is not really expected to draw upon the competencies of his subordinates, or defer to them, in making his decisions. He is apt to be hostile to the ideas of subordinates—and of co-equals, for that matter. At the same time, there is much in the culture of such professional workers as scientists and highly trained engineers that resists traditional management approach.

Neo-Scientific management takes a different approach and a different view of organizational behavior. This is symbolized by the word "colleague," which is used to describe it. The very word "colleague" refers to an association or alliance of equals who work together and who hold one another in esteem and mutual respect. Correspondingly, status inequalities are accepted that in other relationships would be conspicuously differentiated and hierarchical. The idea of colleagueship and the term "colleague" have their origins in the craft guilds of a much earlier day. Authority in the Neo-Scientific management rests in the group, ultimately, and is given to a leader, in contrast with the authority of the Traditional management, which is the authority of the bureau and the office. While there are differentiated decisional responsibilities, and management controls in the Neo-Scientific organization, they are defined by problems, skills, and demonstrated competence. Recognized needs to know and to participate in policy making and planning are broad. Rules are by agreement, and compliance is a matter of voluntary assent rather than coercion.

The Neo-Scientific manager has the same responsibility that management has in the Traditional situation, but his viewpoint is strikingly different on the whole. To the Neo-Scientific manager, people are *not* by nature indolent, passive, resistant to organizational needs, and the like. It is assumed that individuals have their various potentials and are motivated to develop their talents and to achieve at levels consistent with internalized norms, standards, and expectations. Management does not put these motivations and standards into people. They are already there, and it is management's job to facilitate their development, expression, and achievement. Correspondingly, organizations should be structured and arranged principally so that people can meet their needs. These needs, moreover, are, characteristically, "higher order" needs in contrast with the physiological, basic-security, and lesser social needs of human beings.

In conclusion, I hope I have written usefully for management students. This is sometimes hazardous, and for peculiar reasons. For example, not long ago, a writer decided that some sociologists deserved to be chastised. He said they had produced "a sociology for the manager," thinking, no doubt, that he was choosing his bad words carefully. But did he? Management is an art or technology that inherently is neither good nor evil. The ends and values of management are as varied as those of the managers, the persons, and the groups whose needs and norms they affect. Managers and the managed, difficult at best to delineate in the modern world, are not bad and good, respectively, as the characters are in TV westerns. Policy and management questions throughout the history of the behavioral sciences have evoked some of the most important inquiries and applications. Furthermore, it is just possible that fuller use of the behavioral sciences by managers may yield a greater measure to the commonweals of the world—be the yardsticks those of productivity, personality, or even conceivably, profits.

Problem-Solving Behavior in Organizations: A Functional Point of View[*]

I.

> It is important to note that propositions about human behavior, *in so far as it is rational,* do not ordinarily involve propositions about the psychology of the person who is behaving. Let us explain this rather paradoxical statement. In a given situation, and with a given system of values, there is only one course of action which an individual can rationally pursue. It is that course which under the given circumstances maximizes the attainment of value. Hence, psychological propositions, other than a description of an individual's value system, are needed only to explain why his behavior, in any given instance, departs from rationality.[1]

If we restated what Herbert A. Simon has said in this quotation it would be that when there is only one reasonable course of action open to a man we are seldom in difficulty as to how to explain his behavior; or, in other words, the task of psychology and other behavioral sciences is to explain behavior that is not rational. I would carry matters even further and contend that the task of the social sciences is to discover the rationale of behavior *whether or not* it appears to be rational. The major conclusions of this chapter will be that man's behavior can seldom be as wise as we generally assume it can; and that it is usually wiser than we think it is.

In this chapter the author's goal will be to move the reader closer to a point of view that will help him to analyze business policy cases and to develop policy proposals that are both realistic and productive. The topics covered are ones that usually bear such labels as "decision making," "problem solving," "goal setting," and "planning." Sometimes such words will be used, although with peculiar emphasis. The approach will be strongly oriented toward how people actually *do* behave rather than toward how they *should* behave.

This concern with how people actually behave (a descriptive approach in contrast to a normative one) is in frank revolt against the usual hodgepodge of business writings which confuses what *is* with what *ought* to be (in some particular writer's opinion). My revolt is, in part, stimulated by the fact that students usually come to a case method course with such a full quiver of notions about good and bad practice in business, about human nature, and various related topics, that they can seldom give diligent attention to the case material in front of them. For example, students at the beginning of a course sometimes ask hopefully, "Will I be more decisive by the end of the course?" With an effort I have suppressed saying, "I *hope* not." The tendency of students at the beginning of the course is to evaluate confidently the behavior of everyone in the case as "good," "bad," "*he's* right," "*he's* wrong," "fire that man," and to propose the launching of courses of action that are marked by heroism but untainted by the better part of valor: discretion.

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[*] Prepared by Raymond A. Bauer, Graduate School of Business Administration, Harvard University.

[1] Herbert A. Simon, *Administrative Behavior* (2nd ed.; New York: The Macmillan Co., 1957), p. 149.

Admittedly, the goal of a business policy course is to move toward action, or more specifically toward the devising of policy which will lead to action. Productive policies, however, are dependent on perceptive analyses and on realistic assumptions as to what is possible. Insofar as the human aspects of the cases are concerned, the goal of this chapter is to facilitate such perceptive analyses.

Much of the discussion, particularly that in the earlier pages will be concerned with individual behavior, and may seem, at first, to be remote from the broad problems of business policy. To a large extent, this results from the fact that a psychologist is more accustomed to cutting into problems from this direction. Hopefully, the points of view introduced in the early sections will prove to have greater generality when toward the end of the paper, an effort to apply this understanding of individual behavior to policy problems is made.

II.

Normative, Descriptive, Simplifying Assumptions, and the World

For sake of simplicity we may say that all propositions may be divided into two categories: (1) normative or value propositions, and (2) descriptive propositions or "statements of fact." A typical normative or value proposition would be: "Making profits is a good thing." A typical descriptive or "factual" proposition would be: "If we increase sales by 10% over the coming year, we will make a profit." Note that either can be accepted without accepting the other. Of course, the world does not for long stay so simple.

If we believe that profits are a good thing, we note that generally an increase in sales will bring more profits. Pretty soon we are found saying: "An increase in sales is a good thing," although in point of fact an increase in sales may at times bring about a decrease in profits. Or, confusing things in the opposite direction, we may take standard practice to be "good" practice. If most firms in an industry are following the same practice there is a tendency to assume "they must know what they are doing." Examples of both tendencies in the business world are incalculable.

One of the most demanding intellectual tasks facing us is that of keeping normative and descriptive propositions in their proper places. This, regrettably, has not become standard practice in business thinking. The major areas of confusion have to do with the motivations of man and with his methods of solving problems. This confusion stems on one hand from old-fashioned economics and on the other from organizational theory.

Economists embarked on the task of developing a descriptive model which would enable them to *explain* and *predict* the behavior of the economy. (In earlier days, at least, most economists would have foresworn the usual third purpose of a science, for example, to *control* the economy.) In order to keep the job within manageable proportions, they did what all theorists do and must do, namely, make simplifying assumptions.

It is a cliché in sophisticated methodological circles that assumptions are neither true nor false; they are either useful or not useful. Hence we have no quarrel with the assumptions per se, but leave entirely to the economist to decide on whether or not they were helpful. Many of course have been changed and refined over time, indicating that they had outlived their usefulness.

Perhaps the most discussed of these assumptions is that of "economic man," which holds that man will act so as to maximize his expected monetary value.[2] While economists were able to do a considerable amount of productive work while using this assumption, it was also clear that the simplifying assumption was not always an accurate description of the way in which men actually behaved. In some circles at least a pernicious process took place. Men were blamed for not acting according to the simplifying assumption, and the label "nonrational" or "irrational" was applied to such deviant behavior. In some instances an attempt was made to use such terms in a strictly technical sense, but the general trend was to put a normative evaluation on behavior which was not directed at maximizing expected monetary value.

Note the process. A neutral, nonnormative simplifying assumption drifted into taking on normative status. In many quarters to this day, it is held—sometimes explicitly, often implicitly—that this is the way men *ought* to act.

But strictly economic thinking is not the only area in which the assumption of "economic man" became a norm. A related trend took place in organizational theory. Organizational theorists of an earlier day had an explicitly normative orientation. They were strictly concerned with designing better organizations, whether they understood them or not. Naturally some theory of human motivation was necessary, and the concept of economic man was available and, in fact, accepted as "natural." Furthermore, it fitted in well with many other features of a "rationalized" organization. Money is a generalized medium for controlling an organization and planning its activities. It is a measure whereby the performance of the organization and its parts may be judged. It is a means for achieving organizational objectives such as building plant, buying machinery, *and* motivating workers. Any worker, therefore, who deliberately restricted output when he could have earned more money via a piece rate incentive system was judged "irrational," which though it pretends to be a comment on his mental processes actually does no more than to say that he did not conform to the organizational blueprint.

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[2] Some readers of an early draft have contended that the stereotyped image of "economic man" is a straw man. I would certainly agree that I know no sophisticated modern economist who has so simple-minded a notion of human motivation—or at least who could be caught espousing it explicitly. Yet it has penetrated into much of our thinking, and many people who would deny it *act* as if it were so.

Organizational theory, however, was different from economic theory in that it had an explicitly normative point of departure. Men like F. W. Taylor and his successors were concerned with building better organizations and better practices. A normative goal for the organization, however, should be based on a descriptive theory of human nature, just as good bridges are made with realistic assumptions about the laws of physics and mechanics. But they traveled the road, already pioneered by the economist, of taking a simplifying assumption and tacitly converting it into a normative proposition.

In the meantime, of course, there have been men who kept the issues straight, especially the writers who label themselves explicitly as "normative decision theorists."[3] Holding no illusions about how people actually behave in business situations, these men, if they have a fault, could be said to be overly jaundiced. They have set themselves the task of devising methods for making better decisions, and are concerned with keeping straight the distinction between the way people actually behave, and the way in which they ought to behave.

Their disciples, however, are not always equally faultless. Armed with "the truth," they sometimes become intolerant observers of actual behavior. Because businessmen do not behave the way the normative model says they should, such students often contend that the behavior does not "make sense."

A happy exception to this is the work of C. J. Grayson, Jr., on decision making in the oil industry.[4] Trained in normative decision theory, Grayson went into the field to see how practicing oilmen actually went about deciding whether or not to drill for oil. While Grayson was concerned with improving practices, he did not let his own conceptions of how things ought to be done get in the way of a sensitive and perceptive understanding of why these men behaved as they did. Unfortunately, however, it is difficult to cite more instances in which the relationship between the author's notion of how things ought to be done and his analysis of what actually was done is handled so gracefully.

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[3] The most reasonable example to cite would be Robert O. Schlaifer, *Probability and Statistics for Business Decisions* (New York: McGraw-Hill Book Co., Inc., 1959).

[4] C. Jackson Grayson, Jr., *Decisions Under Uncertainty, Drilling Decisions by Oil and Gas Operators* (Boston: Division of Research, Harvard University Graduate School of Business Administration, 1960).

Unhappily the vast literature on decision making in business, economics, and statistics is generally confused on whether or not it is depicting what is or what should be done. As Cyert, Simon, and Trow report, the usual description of the rational choice process goes something like this:

1. An individual is confronted with a number of different, specified courses of action.
2. To each of these alternatives is attached a set of consequences that will ensue if that alternative is chosen.
3. The individual has a system of preferences or "utilities" that permit him to rank all sets of consequences according to preference and to choose that alternative that has the preferred consequences. In the case of business decisions the criterion for ranking is generally assumed to be profit.[5]

Judged by the contexts in which such models of the decision process occurs, we may judge that various authors accord them some combination of the following statuses. They are:

1. A normative model for businessmen.
2. A convenient way for a scholar to analyze a problem.
3. A convenient way for a scholar to give some order to what he sees other people do in a less orderly fashion.
4. A description of what businessmen do.

Such models do the most harm if they purport to be, or if they are taken by the reader as being a description of actual practice. They ought to do the least harm if they are clearly accorded the statuses of (2) and (3) above. If they are accepted *uncritically* as normative models, they can do harm to the extent that they are unrealistic and get in the way of an assessment of what is possible.

Further examples of confusion of normative and descriptive approaches to business behavior will be introduced in subsequent sections of the chapter. The discussion up to this point should, however, provide an adequate basis for alerting the reader to the fact that failure to differentiate between normative and descriptive approaches to behavior, particularly problem-solving behavior, in organizations is undesirable.

If the reader feels dissatisfied with the preceding pages, this dissatisfaction may in itself be an unwitting documentation of the main point of the sublety with which the normative and descriptive are confused. Suppose one correctly points out that many economists and organizational theorists have an immaculate record in keeping straight the nature of their assumptions about human nature. This might seem to argue that I have overstated the case. But the point at issue is not whether the best people have kept things straight, but that there are certain natural processes that take place which *tend* to confuse the matter. In almost all their everyday usage the words based on the root "norm" reflect this tendency. Thus, in medicine, a "normal" temperature means simultaneously that this is the *usual* temperature that people have, and that it is an indication of health. But, take the statement, "It is normal for people of your age to exhibit these symptoms." Is this a good thing? If in fact such a tendency is offset by other forces this no more negates the generalization than does the ability of my chair to keep me from falling negate the law of gravity. A "tendency" only tends; it does not necessarily prevail.

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[5] Richard M. Cyert, Herbert A. Simon, and Donald B. Trow, "Observation of a Business Decision," in Albert H. Rubenstein and Chadwick J. Haberstroh: *Some Theories of Organization* (Homewood, Ill.: The Dorsey Press, Inc., and Richard D. Irwin, Inc., 1960).

III.

They May Be Wiser Than We Think

As a change of pace this section will be devoted to a few illustrations of how diligent analysis can make sense out of what at first appears to be incongruous behavior.

One such illustration is afforded by some research currently being conducted by Neil H. Borden, Jr., on the introduction of new products to supermarkets.[6] A typical sequence of events is: a salesman makes a presentation to the buyer of a corporate supermarket chain; the buyer after listening to the presentation, reports his recommendation to the buying committee. The buying committee makes a decision to accept or reject the new product. This decision is then reported back to the salesman.

There are certain peculiarities of the interaction between the buyer and the salesman. As the presentation begins, the buyer is sitting at his desk, but, as time passes, he moves his chair back from the desk, preferably into a corner, thus placing distance between himself and the salesman. During this "ballet," the buyer listens with little show of feeling. In general, he does not give any signs either of approval or disapproval of the product being presented. Missing from the interaction is one of the supposedly characteristic features of face-to-face communication—namely, "feedback" from the audience to the communicator.

The salesman, on his part, is careful to avoid forcing the buyer into committing himself one way or another. In a long series of these interactions, Borden reported no one instance of the classic "close" of the salesman whereby he attempts to get the customer to commit himself. If the verdict is negative, the buyer passes the responsibility on to the buying committee saying, "They said no." In actuality, however, the buyer has almost always made his decision before the salesman leaves, and the committee almost always goes along with his recommendation.

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[6] These findings were communicated to me personally by Mr. Borden and are reproduced with his permission. He is doing this research in the Division of Research of the Harvard Business School under a grant of Fairchild Publications, Inc.

Since this performance violates some of our notions of the salesman-customer relationship we may wonder what is going on. This is scarcely the "typical" hard-driving bargaining relationship. Why does the buyer, supposedly in command of the situation, draw back and become noncommittal? Why does the salesman, with supposedly much at stake, fail to push for a committal? But, the classic analysis of the sales situation usually focuses on a single transaction. To understand what transpires we must view this behavior in a broader context than that of the single event. These buyers and salesmen know each other over a long period of time. From a "strictly business" point of view it is important to maintain good relations. Furthermore, they get to know each other as human beings. It becomes a source of strain on the salesman to press the buyer for a commitment, or for the buyer to refuse acceptance to the salesman. In this situation it becomes a convenience to pass the responsibility of the decision onto a buying committee.

Is this a "good" or a "bad" situation? Obviously this is a hard question to answer. All I would contend is that a close look reveals a clear and obvious benefit from this ritualistic behavior: The salesman and the buyer are helped to continue in a relatively unstrained relationship with each other. Where there is no buying committee, Borden reports, a more typical salesman-customer relationship prevails.

But sometimes things get more complicated. One day Borden accompanied a salesman who was promoting a new type of product which his company planned to support by a television promotional campaign extending over several months. In the course of this presentation the salesman became flustered and proclaimed that the promotional campaign would consist of 144 spot television commercials per week! Actually the planned weekly promotion called for about eight spot commercials; the 144 figure was that for the entire campaign! The buyer listened to the presentation impassively. A week later, Borden sat in on the buying committee meeting. The buyer repeated the sales presentation faithfully, including the 144 television spots per week! The committee was equally impassive in the face of this barrage of commercials and turned down the product on the grounds of its malfit with the existing product line.

This is the point at which we should run the film backward and ask what is going on. Surely a promotional campaign of 144 television commercials per week would sell sawdust to wood cutters! Might we not well conclude that these men had achieved their jobs through sheer chance, or that they paid *no* attention to promotional campaigns, or that the batteries in their hearing aids had all gone dead simultaneously? Seemingly only some such drastic circumstance could account for this behavior; yet none of these explanations is appropriate.

The simple fact is that executives of supermarket chains are more familiar with certain types of promotion than others. Particularly they understand newspaper campaigns (that is how they do their own advertising). As a result, knowledgeable sales managers for new products place *one* advertisement in a local newspaper so that the salesman can approach the supermarket buyer with a copy of the proposed advertisement, together with the date on which the ad will appear.

Apparently, while neither buyers nor higher executives of such chains are always aware that 144 TV spots per week is a preposterous figure, they do know a good newspaper advertisement when they see one. Furthermore, if they see the date on which the ad is to appear they recognize the advantage of putting the goods on the shelf in advance of that date.

Suppose we had stumbled onto this situation afresh without any knowledge other than that this particular salesman chose to use a single newspaper advertisement as an integral part of his sales presentation when his company's main promotion is to be via radio and/or TV? Might we not have doubted his sanity? But once we know the facts of the total situation the functionality of the salesman's behavior is clear. This is not to imply that there may not be better strategies available to him, but we are at least convinced that there is more sense to his behavior than might at first meet the eye.

What about the supermarket executives? How rational does their behavior seem? Since they have succeeded in a highly competitive industry, we would be loath to question their ability categorically. On the surface, it would seem that it would be worthwhile for them to learn more about promotion by media other than newspapers. However, without more knowledge of the demands on their time and energies, we cannot conclude that they have, in fact, made a poor choice.

Let us consider further illustrations from the field of advertising. Recall, first, the opening quotation from Simon to the effect that there is little need to explain behavior when only one obvious course of action is open to the actor. The multiplicity of reasonable alternatives in the field of advertising makes it an enticing source of illustrations for the complexity of rationales that may guide a businessman's behavior.

Advertising, furthermore, is a field in which there are many data and much research; sometimes the data show that there is no doubt about the success or failure of an advertising campaign. But then what? Even when it is clear that a campaign is successful, so many elements have entered into that success that it is difficult to know to what to attribute the success—the promotional theme, its creative treatment, the art work, repetition or skillful alteration of copy, or perhaps the medium. And suppose it is obviously the medium that caused the success? What aspect of the medium deserves the credit? Take an advertisement in a magazine for example. Is it the sheer magnitude of the circulation? Or was it the particular qualities of the magazine's readers? Or was the success caused by the particular compatibility of the magazine's editorial content?

Alfred Politz has taken the difficulty in determining just what makes an advertisement effective as the point of departure for a very provocative article.[7] His concern is with the creative dilemma of the copywriter who in the absence of any clear guidelines as to what in his copy makes his advertisement effective looks for other guidelines. Particularly he courts the approval of clients and colleagues by conspicuous "creativity." Politz complains that the result is excessive gimmickry in copy writing, and a deliberate avoidance of straightforward copy that has no obvious "creative" aspect to it.

But, if we take Politz at his word that it is very difficult to tell what makes advertising effective, then there is no reason to accept his verdict that gimmicky "creative" copy is less effective than straightforward copy. It seems just as legitimate to interpret his observations in another way: In the absence of any good evidence that one type of copy is better than another, the writer chooses that type of copy that betters his relationships with clients and colleagues. Regardless of which way we look at it, both approaches agree on one thing: The explanation for the type of copy written is not to be found in its ability to move goods, but in its ability to impress clients and gain the approval of colleagues.

Similar findings came out of research done by Gerald Simon on the behavior of advertising media space buyers.[8] The problem, as originally formulated, was that of discovering how quantitative measures of magazine audiences were used in media-buying decisions. Each of the measures (circulation, number and type of readers, pass along readership, and so on) has its proponents, its advantages, and its disadvantages.

Simon's first finding was that the men whom he interviewed did not use these measures in a single consistent fashion. At first he was tempted to throw up his hands and say that their behavior "didn't make sense." Their behavior began to take pattern as he came to understand the variety of problems with which these men were coping in using these quantitative measures. He discovered that the quantitative measures were used only partially in the original media selection decision. As a matter of fact, other, more intuitive criteria (for example, compatibility of the editorial content of the magazine) were often the basis for selection. The quantitative measures were often used to justify this decision after the fact; thus selection of the "appropriate" measure more often than not was a function of agency policy, or the preference of clients for particular criteria, or even the ability of clients or superiors to comprehend particular statistics.

The "problem" of the media buyer turned out not to be a simple and straightforward one of manipulating quantitative data, but rather a complex social problem involving subtle relationships with buyers, other agency personnel, clients, and media salesmen. This social problem involved not only a variety of personnel, but the values, expectations, egos, and intellectual capacities of each. While the buyer had his own media preferences, he also had the need to maintain viable relations with the other persons of the drama. Therefore, he worked not for a definitive answer but a viable one which represented some mix of his various needs in the situation. In this social process, the quantitative data were not *the* exclusive basis for choice of media, but were merely *a* basis for choice, which could also be used, when and where suitable, for rationalizing and communicating the decision to clients and colleagues.

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[7] Alfred Politz, "The Dilemma of Creative Advertising," *Journal of Marketing*, October, 1960, pp. 1–7.

[8] These findings were reported personally by Mr. Simon and reproduced with his permission. Mr. Simon is presently a partner of the Cambridge Research Institute, Cambridge, Massachusetts.

All of the above examples have one common characteristic. In each case, an observer content to judge the behavior against a fixed normative model might very well have dismissed it as hopelessly chaotic. However, it is clear in each instance that a little persistence in search for some patterning in the chaos revealed more sense than might initially have been anticipated.

Before we leave this section, I should like to make it clear that it has not been my intention either to eulogize or to condemn any of the above behavior. The reader may feel confident that in each instance each of the actors could have done *much* better. My own opinion is that considering the complexities of the situations and the limitations on my own knowledge I would not care to guess whether or not these men could reasonably be expected to act "more rationally." Nor is it necessary to make this judgment. What is essential to these examples is an appreciation of the dangers in measuring and judging complex behavior against an overly simplified normative yardstick. Not everything we cannot at first understand is irrational.

IV.

System and Function

It would be unusual to define or describe a spark plug except as part of an internal combustion engine. It would be even more unusual to evaluate a spark plug as "good" or "bad" except in reference, explicit or implicit, to how the spark plug contributed to the functioning or malfunctioning of the engine. Since a spark plug is part of a system, we do not know what to make of it unless we understand its role in that system, and how well it plays that role. If it did odd and exotic things in contrast to "normal" spark plugs, but the engine functioned superbly, we would be inclined to consider it a "good" spark plug.

It is odd how quickly we can accept the notion that a spark plug must be evaluated as part of a system and judged according to the way it functions in that system—and how reluctantly, or with what difficulty we take a similarly functional point of view about individual and organizational behavior. One of the most persistent errors made in assessing human behavior and the operation of organizations is to evaluate them without respect to their role in an explicitly defined system. This occurs in a variety of guises and scarcely ever has anything to recommend it except a certain parsimony of effort.

Applied to human affairs, the functional point of view consists of analyzing the behavior of individuals or organizations in terms of larger systems in which they play a role.

A first step to understanding the difficulty of functional analysis is the appreciation of the variety of systems within which a given phenomenon may be analyzed. For example, the internal combustion engine is not the only system of relevance for evaluating a spark plug. An internal combustion engine is composed of subsystems, one of which is the ignition system. A given plug may have different operating characteristics in a 12-volt and in a 6-volt ignition system. Or we may turn our attention to a larger system, namely the sociotechnical system within which the maintenance of the automobile is to be carried out. Suppose we have an ignition system that has very desirable operating characteristics, but is very difficult to keep in adjustment. Will our evaluation of the ignition system not be influenced by the question of whether the automobile is to be owned by a garage mechanic or by a college professor?

Obviously our evaluation of an element will vary considerably depending upon the system in the context of which it is evaluated. But the matter does not end there.

Unfortunately "systems" are not God-given entities, although our familiarity with the names applied to many familiar systems may cause us to miss this point. Typical "systems" with which we are concerned in studying behavior in organizations are: personality, informal group, functional department, firm, and society.

While the task of defining the boundaries of such systems may not *always* pose practical difficulties, the issue may as well be faced up to at this point. For example, it is a moot point as to whether customers are or are not part of the system called "the firm." Certainly it is not possible to plan the actions of the firm without "systematic" consideration of the customers. If the reader thinks this point is captious, let him then try the task of assessing the "interest of the firm." Who does he include? The management and/or employees? The stockholders? Common or preferred? If it is a subsidiary of a larger company, is it the interest of the parent company, or the interest of the subsidiary? Should General Motors policy have been set in the interest of Du Pont?

All of this is not to argue that the case is hopeless, but merely that the student of business policy will have to think, make up his mind, and then be explicit as to how he defines the system he is considering. The reason for this, obviously, is that if he shifts systems entirely, or even if he re-defines the boundaries of the *same* system (that is, of an entity to which we apply the same verbal label even though there are various ways of defining its boundaries) his evaluation often changes, and in fact he may invert the evaluation put on the behavior or policy under analysis.

Functionalism, the practice of evaluating events in terms of larger systems in which they play a role, might be regarded as little more than common sense, although common sense with a particular discipline applied to it. In use, however, it produces surprises; it extends, stretches, and sometimes appears to violate common sense. Its power is *most dramatically* demonstrated when it makes sense out of what previously appeared to be nonsensical, or when it uncovers some unsuspected benefit in a situation that seems entirely negative.

Thus, one of the major features of modern psychology is the extent to which it uncovers the rationale of what appears to be "irrational" behavior. And in sociology, functional analysis may reveal how illness can cement relations among members of the family. And, in business, functional analysis may reveal that coffee breaks, car pools, bowling leagues, and other such phenomena may serve to facilitate communications among personnel in the firm.

Functional analysis is the backbone of modern noneconomic social science. It often leads to conclusions that violate the common sense of "hardheaded thinkers," usually because it arrives at different conclusions and interpretations than does a simple old-fashioned approach to "economic man."

Advocates of "economic man" ought to be at home with the basic logic of functional analysis, however. One of the most prominent functional thinkers in intellectual history was Adam Smith whose basic argument was that man's pursuit of his own self-interest had the unintended consequence (read "function") of regulating the economy. For those readers who feel that Smith's emphasis on the "unseen hand" led him to exaggerate the beneficence of things a bit, we hasten to add that modern day functional analysis at times exhibits the same tendency to veer off the road, and make it appear that "all things are for the best in this best of all possible worlds." This point will be returned to.

At the heart of functional analysis is a proposition that might be put into words in various ways such as: "There's a reason for everything." "Nothing would persist if someone weren't benefiting from it in *some* way." Note that these propositions are not necessarily true. What is important is that they urge us to act as though they were true. The status of such "programmatic" statements in intellectual affairs is often confused. Thus, many social scientists are fond of muttering, "If a thing exists it can be measured." Now there are lots of things which they will admit do exist and have not yet been measured, so until they have succeeded in measuring everything they will never be able to prove their point. In the meantime this statement is the foundation for a vigorous program of trying to measure more and more things. Similarly the programmatic underpinning of functional analysis is an injunction to search diligently for the benefits which a given phenomenon conveys to *some* system. The assumption behind this injunction is that no behavior would persist unless there were a set of forces at work supporting it, and that the most usual reason for this happening is that some "system" benefits in some way. The assumption is not logic tight, since it is possible for a person or organization to support some policy "erroneously."

In the meantime, this consideration should not get in the way of our understanding of one of the salient benefits of functional analysis. It reduces the proportion of relevant phenomena which are dismissed as "inexplicable," "irrational," "accidental." It does this in part by the injunction that the phenomenon probably has a positive function in terms of *some* system, and in part by alerting the observer to consider a wide variety of systems in terms of which it may be explicable. In addition, the substantive body of social science supplies an inventory of the variety of functions that are served in some or all systems.

The merits of this need not be labored. Behavior, practices, policies which we cannot understand are ones on which we cannot act systematically and deliberately.

Functional analysis can, however, lead to two fallacies which could well be labeled the teleological fallacy and the Pangloss fallacy.

The teleological fallacy is the error of assuming that because a given piece of behavior has a given function that this, therefore, was intended. Behavior has both intended and unintended consequences. It would be a rare work group that would organize coffee breaks as a means of communicating technical information (although I *have* seen approximately this being done deliberately). However, the coffee breaks may have this function *in fact*. This may be appreciated with varying degrees of explicitness by management, and in particular instances may explain part of management's reluctance to oppose the practice. The notion of *unintended consequences* is a key and powerful concept of functional analysis.

The Pangloss fallacy (so named by me) takes its name from the Dr. Pangloss of Voltaire's *Candide*. Dr. Pangloss was habituated to find a "functional" benefit in the most disastrous of events, pontificating that after all, "everything is for the best in this best of all possible worlds." Critics have argued that functional analysis has a built-in bias toward the *status quo* since the identification of a function of a given practice tends to become a per se justification of it. While this danger exists, it should be clear from the preceding discussion that a given event is likely to be simultaneously functional and malfunctional. Obviously, most of us would find it difficult to make an overall favorable judgment on sickness simply because it has the side effect of bringing the family closer together. Therefore, the concept of function implies an explicit consideration of its reciprocal concept, *dysfunction.*

While there is much more to be said about the functional point of view, it had best be said in a more concrete context in the pages which follow. The essentials of the preceding paragraphs may be summarized, however.

The essence of the functional point of view is that phenomena must be analyzed in terms of their role in a specified system. Specification of the system or systems involved is an essential feature of the analysis. The notion of a plurality of systems in which a phenomenon plays a role is also crucial, since the functions or dysfunctions of the phenomenon vary with the systems of which it is a part. This becomes especially relevant when some apparently dysfunctional state of affairs becomes explicable only when related to some system other than the one in which it first came to our attention. The functionality of any phenomenon is not related to its intention; in fact, the search for unintended consequences of behavior is one of the most rewarding and challenging aspects of functional analysis. Nor are all functions positive. Inherent in the concept of function is the complementary concept of dysfunction. Given a sufficiently diligent analysis any one phenomenon will probably be found to be both functional *and* dysfunctional in one or more of the systems of which it is a part.

V.

"Labeling" versus Analysis; the Case of Irrationality

In this section let us begin by turning to a particular instance in which normative labeling gets in the way of understanding. The instance is the use of the label "irrational" (or nonrational) to describe behavior in an organizational setting. This problem has special relevance because of its prevalence, its practical and systematic importance, and the extent to which the normative judgment is confused with a straightforward descriptive statement. It should be clear before we are through that calling behavior "irrational" *could* be a descriptive statement with some reasonable meaning. However, it will be equally clear that we are very seldom if ever in the position to make this judgment in the sense that is ordinarily implied.

Let us begin with looking at some typical instances in which behavior in an organizational setting is labeled irrational or illogical.[9] The most typical case is that in which someone disagrees with the goals which someone else is pursuing. The piece-rate worker refuses to earn as much as he can in order to avoid conflict with his fellow workers. An executive turns down a promotion because the new job will put too much pressure on him. An office worker refuses a better paid job in the factory even though he has no particular chances for advancement in the office hierarchy. Workers of Puerto Rican ancestry absent themselves from work to visit a sick relative—who will unquestionably survive the illness. A stenographer sulks because another stenographer has been given an electric typewriter. These are all examples of the types of "irrational" behavior which the administrator is told to expect and to deal with.

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[9] The passage which follows is largely dependent on an earlier article of the author: "Who Says People Act Irrationally?" *Harvard Business School Bulletin,* December, 1958, pp. 13–19.

In what sense is such behavior "irrational"? It is "irrational" in the sense that it does not conform to the behavior which is expected of the individual by virtue of his formal role assignment in the firm and because the individual is not responding to the sanctions which have been set up to get him to do this assigned job. Such a judgment of "irrationality" assumes that the individual has only one or at most a very limited range of motives in the work situation—mainly that of earning money. But perhaps he feels it is equally important to get along with his fellow workers, to spend time with his family, to avoid manual labor, to live in peace with himself, or to have the prestige of operating an electric typewriter.

The choice of goals to pursue has *nothing* to do with rationality per se. There is no inherent reason why at a given moment a man should prefer earning more money to any other objective. From everything we know about man—and animals—man is governed by a multiplicity of motives and the work situation offers the opportunity for the satisfaction or frustration of motives which are seldom built into the organizational blueprint. In short rationality is concerned with how a man goes about achieving his goals—a matter of means-ends analysis—rather than of choice of goals.

It is, of course, possible to view the above-mentioned behavior from a point of view of means-end analysis and argue as follows: "If this fellow wants affection, prestige, comfort and ease, the surest way for him to get them is to knuckle down and earn more money." But now we are dealing with an entirely different problem. We have taken his goals as givens and made an assessment of whether or not he has done a reasonable job of figuring out how to go about attaining them.

It might be worthwhile pointing out that in order to make such an assessment we must know: (1) the full range of his goals and the values he attaches to each; (2) the alternative courses of action open to him and the resources which he can bring to bear; and (3) the probable consequences of each of these alternatives. I shall stress later how difficult it is for even the individual himself to have such knowledge.

However, it is highly dubious that many applications of the label "irrational" to such behavior stem from such an analysis. Such judgments stem from assumptions about how people *ought* to behave in a firm. The firm is set up to encourage behavior which is functional to its goals, and uses as its prime sanction economic rewards. Ergo, the man who behaves as the blueprint says he should behave (namely, who tries to maximize his economic take) is regarded as acting "rationally."

In a sense most classical writers (even a great many modern writers on administration) are to some degree the victims of the notion that the rational man is the man who tries to maximize the immediate economic take. It is now pretty well recognized that men want more than monetary rewards from a job, that they want prestige, security, identification with the work per se, approval, and so on. But even though provision is now ordinarily made to afford some satisfaction of these other motives and to build them into the firm's system of sanctions, they are still customarily referred to as "nonlogical" or "illogical" motives.

From a point of view of administrative practice this relegating of certain motives to the category "illogical" or "nonlogical" is probably deleterious since it leads to condescension in the administrator's response to behavior originating from such motives. While it has become part of enlightened administrative practice to acknowledge and accept such "nonlogical" motives, this leads many administrators to deal with subordinates much as we customarily deal with small children and drunks.

This tone of condescension shows up in the writings of some rather good authorities who advise the administrator that while they may expect supervisory personnel to act rationally, they must expect a certain amount of irrational behavior on the part of lower echelon employees. What is at the bottom of statements like this is not that the mental processes of lower level employees are different (this may or may not be so) but that the higher one is placed in an organization the more of one's personal goals are articulated with the goals of the organization. Socializing with one's fellows at the top level of administration is seen as "building the management team." Church and community activities "improve community relations." The executives' own prestige is more directly linked to the success of the organization as a whole and behavior to this end is regarded as rational and functional. On the other hand, much of the behavior of supervisory and executive personnel which contributes to the goals of the firm, would be regarded as "irrational" and malfunctional if it were carried out by the rank and file worker. Thus, much of the greater "rationality" of supervisory personnel is an artifact of the definition of their role in the firm and the *fact* that they are able to achieve more of their satisfactions by behavior which is *seen* as functional to the firm.

Clearly then, the practice of labeling certain behavior in organizations as irrational or nonrational has nothing to do (as might seem to be implied by the labels) with the intellectual process whereby the individual decides to go about getting what he wants. At least in most instances such labels reflect merely a disagreement with the individual's choice of goals. In part, this judgment is the heritage of "economic man." More immediately, it stems from the fact that such behavior is not rational with respect to the organizational blueprint, which actually is the implicit system in terms of which the evaluation is being made. One might often say quite reasonably that such behavior is dysfunctional to the organization, although, as has been pointed out, not *all* such behavior is dysfunctional. However, as we have suggested, the use of money as the most generalized medium for planning and controlling the activities of organizations gives attractiveness to the concept of economic man as a comforting simplification of the administrator's task.

Rationality, therefore, has nothing to do with choice of goals per se. The goals which a man will pursue are the results of the values of his culture and of his own personal life history. They are "givens" in any means-end analysis whereby one might assess the rationality of a person's behavior. And here the equating of "rational behavior" with "money maximizing" is on very tenuous grounds since money is seldom desirable for its own sake, but is ordinarily pursued for the attainment of other goals. Unless one were to argue that all values are best achieved in all situations by buying them with money, it becomes scarcely tenable to hold that maximization of income is *the* rational way of behaving.

While the foregoing discussion has been concerned with the individual's pursuit of specific goals within the context of the system of the firm, there are two other systems in the context of which the individual's behavior must be analyzed. One is the self-system, corresponding more or less to what is generally called personality. The other is the individual's system of social relationships.

Analysis of behavior with respect to the self-system is a very tricky business and in complex instances becomes the affair of psychiatrists and clinical psychologists. The general issue can be stated fairly simply however. Let us once more take some fairly typical instances of behavior that are labeled irrational.

The president of a firm suffers a serious heart attack. After his return to the office it becomes clear to everyone around him that he is no longer able to carry the full weight of his responsibilities. The same evidence, perhaps more, is available to him as to everyone else. He has always placed the interests of the company ahead of his own. Furthermore, he could retire with no financial difficulty. Yet, since he does not retire, the board of directors finally has to force his retirement.

A salesman is called on the carpet. If he listens carefully, the boss is telling him that he is indolent, incompetent, and that his rudeness is alienating customers. If he is going to keep his job, he must accept this image of himself as a preface toward mending his ways. Somehow the message doesn't come through completely. While he may not be able to shut his ears entirely to what is being said, he can downgrade the information by telling himself, "The boss must have caught hell from upstairs, so he's letting it out on me."

It would be easy to label either of these behaviors as "irrational" and perhaps they are. But this labeling is essentially a judgment of the individual's capacity to revise his self-concept, a judgment of how rapidly he can learn to think of himself in different terms without doing serious damage to his self-system.

"Learning" is a process of gradual adaptive transformation of the individual's personality or self-system. If things go well, the individual becomes progressively more capable of dealing with the external world—or as some people would have it, he acts more "rationally." But the individual's personality or self-system, like all other systems, can change only so rapidly without becoming completely disorganized. In order to keep the stress on the self-system within limits, the individual resorts to what we call defense mechanisms—suppression, denial—or rationalization of unpleasant information.

The function of such defense mechanisms, to stabilize the self-system, is readily apparent. The dysfunction, impeding the individual's capacity to relate directly to his environment, is also apparent. What is not apparent is the wisdom of any one bit of behavior. At the very best we could judge the logic or illogic, the rationality or irrationality, of any given psychological defense only within an explicitly defined scheme of analysis, including an agreed upon time period.

Suppose, for example, a small boy becomes obsessively clean. He washes his hands before eating and after, and sometimes between courses. A few years later he joins the Boy Scouts. His peers regard his behavior as "queer." We might readily agree that with reference to the boy's peer group, the behavior is primarily dysfunctional. But, suppose our hero some years later develops into a renowned surgeon. At this time his behavior might be judged highly rational, at least by a new observer on the scene who was not aware of its neurotic origins.[10]

The foregoing, again, is not a eulogy of neuroses. The intent of what has been said is to point to the maintenance of the self-system as a legitimate goal of man's activities. Unless a man were able to keep his personality moderately integrated he would not even be able to maximize monetary gain very well. Perhaps the observer will, if he has the temerity, pass judgment on the wisdom of particular behaviors directed at defense of the self-system. I would hope only that he recognize the intent of the behavior.

Finally, the individual must maintain reasonable stability in his system of social relationships. Much of worker behavior that has historically prompted the label of irrational or nonrational has to do with his response to group pressures. To some extent such behavior falls under our first category of pursuing noneconomic goals in the work situation. But the social group may also be viewed as a precondition to his pursuit of all specific goals. That is to say, even if he is motivated by strictly economic considerations—even if, in fact, he is a rate buster—there is a limit to the extent that he can neglect his ties to other people. This is freely acknowledged on the executive level but it is also true, although possibly to a lesser extent, on lower echelons. In most instances fellow workers can, if pushed to extremes, make the work situation impossible. If the reader prefers the more exalted atmosphere of the executive suite, then it is clear that the top executive must manage a complex system of social relationships both inside and outside the firm. The maintenance of this system of relationships will on occasion (most occasions) require the compromising of specific objectives.

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[10] In my own experience I worked for a number of years in a chemical laboratory. I saved a good deal of broken glassware by developing a reflex action of flipping out my foot to break the fall of beakers and flasks. In the years that followed this highly developed reflex placed my foot in the path of a number of falling objects too heavy and hard to need my protection. Rational?

Thus, there are three "systems": the firm, the self-system, and the system of person-to-person social relationships. Viewed from the point of view of the individual, he has three broad categories of goals: the pursuance of specific discrete goals such as money, prestige, esteem; the maintenance of the self-system; and the maintenance of the social system. The specific discrete goals which are pursued can be divided into those which are functional to the firm, and those which are dysfunctional to it. Those which are functional to the firm must be further subdivided into those which are specifically taken account of in the firm's system of rewards and which, although functional, are not taken account of. It can be seen from the foregoing system of categories why only a limited portion of man's motives are "rational" within the blueprint of the firm.

Another way of putting this is that the rationalities of the firm and the individual are not identical. It is a mistake to judge the rationality of the individual solely in terms of that area which it has in common with the rationality of the firm.

The case concerning rationality has thus far been largely negative. My contention has been that there are patterned ways of using the label "irrational" which get in the way of understanding human behavior. It has not been contended that any of the behavior herein referred to is or is not rational, but merely that it may and probably is to some degree functional within a wider framework of analysis.

VI.

Means, Ends, and Intermediate Points

While we may often be loose in our use of the term "rational," we can when pressed for a sensible, considered statement muster up a set of mannerisms that we associate with rationality: a search for and a weighing of evidence, time devoted to deliberation, consideration of a range of alternatives, logical rather than intuitive thinking, and the like.[11] There are difficulties, however, in letting the matter rest there. In the first place, men using essentially these same orders of procedures come up with different answers. (This does not make such procedures undesirable, merely fallible. Carried to extremes—such as excessive deliberation—they may also be dysfunctional.) Secondly, while certain procedures may have much to be said for them, the quality of a conclusion cannot be judged solely by the mode of thought by which it was derived. Even in the natural sciences there are no fixed rules for how to *get* an idea. The scientific method per se is concerned with testing ideas regardless of the means of their generation.[12]

Up to this point, we have been largely concerned with the rationale of individual behavior. Perhaps now is the time to begin a consideration of rationality in the business policy-making situation. What kind of information, for example, would a person need before it could be said that he was making a rational business decision? One answer has been given by March and Simon.

> A . . . difficulty with existing models of rational man is that it makes three exceedingly important demands upon the choice making mechanism. It assumes (1) that all the alternatives of choice are "given" (or perhaps we might say that the individual is aware of the total universe of possible actions available to him); (2) that all the consequences attached to each alternative are known (in one of the three senses corresponding to certainty, risk, and uncertainty) (that is to say he will not only know the outcome of each action and/or the probability of alternate outcomes, but also the probable cost he will pay for an unfavorable outcome); (3) that the rational man has a complete utility-ordering (or cardinal functioning) for all possible sets of consequences.[13]

This last requirement—that of having a "complete utility-ordering . . . of all possible sets of consequences"—is even more difficult than it may seem. It is customary for psychologists to talk about a hierarchy of motives in the sense that each individual has his own ranked preference of goals or values. While there is a certain attractiveness to this notion, it has at least one profound empirical difficulty. From time to time motives vary in their *degree* of satiation and this circumstance would bring about inversions in the position of motives in the hierarchy. Since rational behavior has to do with achieving desired future states of events, the actor would have to know not only the present relative utility of various outcomes, but be able to anticipate that utility at some point in the future when the predicted consequences occurred.

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[11] For a discussion of such rational behaviors, see Harold Garfinkle, "The Rational Properties of Scientific and Common Sense Activities," *Behavioral Science,* Vol. V, No. 1, January, 1960, pp. 72–83.

[12] Cf. Holton, Gerald, "On the Duality and Growth of Physical Science," *American Scientist,* Vol. XLI, No. 1, January, 1953, pp. 89–99.

[13] March, James G. and Simon, Herbert A., *Organizations* (New York: John Wiley & Sons, Inc., 1958), p. 138.

As March and Simon say: "One can hardly take exception to these requirements in a normative model—a model that tells people how they ought to choose."[14] However, we must appreciate that this type of model affords a description of what one can do in only the simplest of situations. The type of calculation called for by this model of "objective rationality" can be accomplished—within specified limits—by formal normative decision models. When high-speed computers are used the number of variables considered may be staggering if compared to the capacities of ordinary mortals. But even the most elaborate is finite in a meaningful way; that is to say the model builder is explicitly aware of what he has *not* included. As a matter of fact it is only the finiteness of any model that makes it useful; its power lies in its ability to generate useful information with *less* than a complete representation of reality. In any event, not even the most elaborate computer model meets the requirements of "objective rationality" specified above.

There are two ways in which complex human decision making deviates from the model of objective rationality. In the first place man does not ordinarily strive to maximize the utility of a given decision or action. Rather, he sets himself a level of aspiration of a "good deal," or to use the term that Herbert Simon has done so much to popularize, he "satisfices." Secondly he atones for gaps in his information and for the finiteness of his computational capacity by adopting "strategies," "decision rules," or "policies"—or to use a less elegant term "rules of thumb."

Apropos of "satisficing," one might, if he were a stubborn proponent of "maximizing," make various ingenious arguments that this is but a higher order of "maximizing." For example, it might be argued that the individual assesses the cost of gathering additional information and of making additional calculations, and then he weighs these costs against *alternate uses* of his resources. The result then might be that suboptimization with respect to any individual action would be the optimum overall strategy for maximizing the utility of *all* one's decisions. Such an argument is obviously specious since to compute an optimum overall strategy for *all* one's acts taken together would require more information and calculational capacity than that required for any single decision. There is evidence, as we shall see later, that people do consider at least tacitly, alternate demands on their resources, but not with the rigor of an optimizing model.

Nevertheless, the so-called "behavioral decision theorists" have been working hard to discover models for analyzing actual behavior within the assumption that the individual is trying to maximize *something*. Of necessity they have been working with limited problems under rigidly controlled experimental conditions. Even if they had been entirely successful in this enterprise, the restricted nature of the problems with which they deal would leave little in the way of implications for us to draw for behavior of people in complex organizational settings. However, they have experienced substantial difficulties in arriving at an optimizing model for actual behavior in even limited conditions.[15]

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[14] *Ibid.*

If we accept the notion that the individual "satisfices" rather than maximizes, what can we say about how he goes about establishing his level of aspiration? Although to the best of my knowledge it has not been done, there is a considerable amount of psychological writing and of economic and practical data that could be brought to bear on this problem.[16] It will probably suffice to say that the crucial variables lie in part in the individual's personality and in part in his past history with related problems. In general, success will cause a person to raise his level of aspiration. With some persons, however, success will, at certain points, bring about a sense of anxiety and even guilt ("Am I worthy?" "Have I just been lucky!") and at least a temporary lowering of level of aspiration. In general failure will result in the lowering of level of aspiration. Under some circumstances, however, failure will lead to a desperate playing of long shots.

Family background, the ethnicity of one's forebears,[17] the ambitions of one's associates, the standards of one's industry could in any one instance be factors determining the individual's level of aspiration.

A final factor affecting the adoption of "satisficing" rather than "optimizing" strategies is the plurality of objectives with which a person is concerned in an organizational setting. An "optimizing" model designed to maximize one criterion is difficult enough. But, few men, if any, are ready to consider precisely the relative utility of the goals when even a single act may impinge one. It is my personal conviction that, apart from the other difficulties people have with a maximizing or optimizing model, the choice of a satisficing one is made to avoid the conflict of making explicit choices among one's values.

All that can be done in this brief space is to alert the reader to problems connected with level of aspiration. The case data may give him cues as to why the persons in the case have set their sights where they did, or if the reader is devising policy he may gain cues as to the degree of risk the principals would be willing to run to strive to attain a given level of payoff, or the range of values with which they are involved.

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[15] A convenient review of this work may be found in Ward Edwards: "Behavioral Decision Theory" in Paul F. Farnsworth (ed.), *Annual Review of Psychology, 1961* (Annual Reviews, Inc.).

[16] Cf. the relatively early, but thorough statement, Lewin, Kurt, *et al.*, "Level of Aspiration" in J. McV. Hunt (ed.), *Personality and the Behavior Disorders,* Vol. I (New York: Ronald Press Co.), pp. 333–78.

[17] See the classic work on "Need Achievement," David C. McClelland, *et al., The Achievement Motive* (New York: Appleton-Century-Crofts, Inc., 1953).

The second way in which human decision making deviates from the model of rationality is the development and use of "decision rules," "strategies," and "policies." In the sense discussed here, these phenomena, also, have received less attention than they deserve. This seems to be due at least in part to the low status accorded to "rules of thumb," which is but an inelegant label for much the same phenomena. In a related fashion, this inattention is also due to the normative bias in almost all writings on how businessmen actually behave. It is hard to find a literal description of a business decision. Accounts of actual decisions, in most but not all instances, reorder the events and behavior to fit such standard categories as "defining the problem," "searching for alternatives," "weighing alternatives," and so on. There is a danger that readers will erroneously conclude that the actual decision-making process was as formal and "rational" as are these discrete and logical categories.

Rationality has been discussed as involving (but not as synonymous with) means-end analysis. In essence, means-end analysis involves a projection of a sequence of events into the future. The most important of these events, the "goal," is the most remote in time, and being the last in the sequence it is dependent on all the intermediate events. Paradoxically this generally means in practice that the "goal" is a poor guide to action.

A conclusion like this requires further elaboration; so let us examine a favorite business cliché that the goal of a business firm is to "maximize long-run profits." In practice, this is not an operational goal or, put another way, it is extraordinarily difficult to tell if a given action leads to long-run profitability. Take a typical example: a research-based firm suffers a poor first quarter. The president orders a cutback in all expenses, including expenses for research. His rationale is that a precondition for successful operation of his research-based firm is that the financial community should have continuing confidence in its profitability so that he may, when he needs, procure outside capital to invest in research. How do we weigh the cut in this year's research budget against his long-range ability to recruit capital?

What happens in practice is that "means" become "ends"—at least in part. Policies are established, and justified by expectations that they will lead to long-range profitability. Such policies typically are: increasing share of market and/or increasing profitability as a percentage of sales, achievement of a reputation as the leading company in the industry, development of a sound organization prepared to meet the challenge of growth over the next decade, maintenance of a certain rate of annual return on investment, diversification in such a way as to make optimal use of the firm's existing skills, or alternately diversification so as to minimize risk from fluctuations in the market for one's product.

The point I want to make about such policies is best illustrated by two popular but contradictory folk decision rules: "a stitch in time saves nine," and "haste makes waste." Sensibily reconciled, these aphorisms say little more than "sometimes it pays to go fast and sometimes it pays to go slow." In fact, the typical policies listed in the preceding paragraph share certain characteristics with these homilies. All of the policies cannot be pursued simultaneously since certain pairs would lead to contradictory courses of action, or at least to marked compromises. Furthermore, each of them may or may *not* lead to long-range profitability in a given instance. The reader will have no difficulty in imagining instances in which any one of such policies could prejudice long-range profitability. It is obvious, for example, that short-run profits may be gained at the expense of long-run profits.

The merit of such typical policies is that they are "operational," which is to say that within a reasonable length of time one can observe whether or not he is meeting his objectives. "Maximizing long-range profits" is not an operational goal for two reasons. Easy to see is the fact that the appropriate observation could only be made at the *end* of this long-range period, however long it may be. Equally crucial, however, is the fact that even at the end of the period, no matter how good profits had been, it would not be possible to compute whether or not the profits obtained were the maximum possible. To do this we would have to compute the profits which would have accrued from every possible combination of actions over the time period. Therefore, the "means" toward the goal, that is, the policies which are operational goals, take on the characteristics of ends and become desirable in themselves.

This conversion of means into ends takes place throughout human endeavors. Take the case of the junior executive who sets his sights on becoming president. He lays out an explicit or implicit program of action with intermediate objectives. One policy may be to get himself known personally to top management in a minimal length of time. Soon he regards a "Good morning, Jim" from a vice-president as a desirable end in itself.

Nor is the field of organizational theory itself free from such confusion. "Theories" take on a normative overlay that confuses their proper role in our thinking. Thus one school of organizational theory stresses the importance of span of control, citing the importance of placing limits on the number of men reporting to any one executive. Another stresses a "flat" organization, pointing to the difficulties engendered by multiplying the number of echelons through which communication takes place. A close look at the two "theories" shows that each has characteristic advantages and disadvantages, and either if pushed to an *extreme* would be catastrophic. In the welter of controversy, however, each proposition tends to become an unanalyzed "standard of good practice" applied without due consideration of the specific situation being considered.

As students of business we are interested not only in the functioning but also in the origins of such decision rules. What is there in business experience that generates these generalizations that reduce our needs for information and calculation? Again, the two broad categories which are relevant are the personalities of the men involved, and the business histories of these men and their organizations. Thus, we may find that a given man will consistently favor caution, tight control over the organization, and a conservative fiscal policy; another may favor far looser controls and more liberal fiscal policies. Or the experience of the firm may dictate preferred policies. Thus, in an actual instance two firms in a heavy equipment industry each tried diversification into consumer goods. For what seem to be accidental reasons, one succeeded and the other failed. When the presidents of the two firms were later interviewed, one said: "We learned that we should restrict diversification to businesses similar to our own where we ourselves have the requisite skill and know-how." The president of the other firm said: "We've learned that our best diversification policy is to go into businesses as little like this as possible. This way we spread the risk."

An interesting feature of these two policies is that both make sense. And this brings us to another characteristic of such decision rules or policies. They are usually uninteresting unless there is at least one semicontradictory decision rule that we would take seriously. In a sense this is a repetition of the quote with which we began: When only one course of action is reasonable, then there is little need to explain behavior which conforms to that reasonable course. But since such simplicity is extraordinarily rare in business problems, there should be few if any decision rules which can be applied in a rote fashion. It is true that in some predominantly technical areas, such as the use of mathematical models for inventory control, there are procedures which are clearly preferable to the methods they have displaced. But the really serious arguments about business policy and business philosophy are those where a strong argument can be made for each of two or more opposing positions.

Since so many issues have been raised, it might perhaps be in order to restate the skeleton of the argument. "Objective rationality," simply conceived, is impossible. Actual behavior is best conceived of as aiming at a limited rationality. It is limited in the first instance by the fact that the individual strives for an *adequate* rather than for an *optimal* solution. Both in analysis and in realistic policy formation, one should take into consideration the level of aspiration of the actors in the case.

The other aspect of the limits on rationality stems from the finite nature of man's knowledge and of his computational ability. If he tried to maximize, as he may by use of formal decision theory, he can do so only within the boundaries of a limited set of variables. What happens in practice is that the individual (or, for that matter the organization) develops a set of decision rules or policies which bridge the gaps in his information, and abridge his computational problems. No criticism was leveled at such decision rules per se. If we consider the limitations on rationality already mentioned such decision rules seem to be necessary compromises. They are especially justified in repetitive programmed decisions for which the cost and bother of regular reconsideration might be prohibitive.

Our attention, as is appropriate for a business policy text, has concentrated more on nonrepetitive, unprogrammed decisions. In this context, it was pointed out that such decision rules or policies tend to take on a normative tone over time and become valued as ends in themselves, or as criteria of good practice to be applied across the board.

Thus, when we consider a specific policy decision it is extremely important to be alert to these characteristics of available decision rules or policies. Unless they are indeed being considered as goals in themselves, it is important to analyze carefully their instrumental or "means" role. Most specifically, despite the vigor and self-assurance with which philosophers of business declare their preferred position, no generally offered standard of good practice is equally applicable across the board. Considering the complexity of actual business events, any proposition with universal applicability would in all likelihood be trivial.

VII.

Decision Making or Social Process?

Up to this point I have used the term "decision making" without questioning its appropriateness. Now we had better consider the use of this term in the light of what we know. Well, we know these to be facts:

1. That men do things and that often, but not always, actions are preceded by an appreciable amount of mental activity.
2. That most statements about the nature of "decision making" are made by men who spend a lot of their own time in deliberate contemplation of problems.

It will be my contention in this concluding section that the usual model of the *process* of decision making is misleading in essential features because it treats the process as an *exclusively* intellectual one, artificially removed from those social processes in which men customarily become committed to action. A prototype of what we are here moving toward is the case of the media space buyers described earlier. The reader will remember that his behavior made sense only when we realized that the range of problems with which he was concerned was wider than had initially been anticipated.

For our present purposes we may reconsider the ordinary description of the choice process in the literature. Cyert, Simon, and Trow present such a description—with the admirable goal of examining its limitations:

1. An individual is confronted with a number of different, specified alternative courses of action.

2. To each of these alternatives is attached a set of consequences that will ensue if that alternative is chosen.

3. The individual has a system of preferences or "utilities" that permits him to rank all sets of consequences according to preference and to choose that alternative that has the preferred consequences. In the case of business decisions the criterion for ranking is generally assumed to be profit.[18]

I will paraphrase the conclusions of their comparison of this usual model with what they found in an actual business situation.

1. In the real world the problem is not a "given." An important function in the organization is to search for problems to which attention should be given.

2. Neither is the range of alternatives of action given. Search for the alternatives of action represents an important problem in itself. This might be a trivial consideration if *all* alternatives were located. In actuality the search for alternatives stops when a "sufficient" number have been located. Therefore, certain conceivable alternatives have been ruled out before any systematic consideration takes place.

3. Next the consequences of each action are not given but must in turn be searched. In principle, the consequences of a single act are infinite; therefore, a "sufficient" search again must be conducted, with the extent of this search being in part a function of the cost and effort involved.

4. Moreover, for reasons to which we have already addressed ourselves, the criterion by which alternatives are compared is not the single one of "profit." Rather it is a mixture of intermediate organizational objectives. As stated by Cyert, Simon, and Trow, "The decision-maker is usually concerned with finding a *satisfactory* alternative—that will attain a specified goal and at the same time satisfy a number of auxiliary conditions."[19]

5. Finally, while the traditional model depicts a choice of the best among several alternatives, in practice individual courses of action are often considered "on their own merits," and not in comparison with other possible alternatives. Thus, the choice frequently ends up in terms of "doing something" or "not doing something."

In the work of Cyert, Simon, and Trow, although some drastic modifications of the traditional model are introduced, the traditional model is adhered to in one essential sense. It is still treated as an *intellectual* process, although one which produces outcomes different from the traditional "rational" models. An entering wedge, however, is offered for considering the social aspects of the problem by one finding, that is, the importance of communications when the intellectual process takes place in more than one head. Added to this are the recurrent emphases by these writers on the *search* process as an organizational activity in the course of problem solving, the reference to the problem *seeking* function in the organization, plus my own suggestion that the "satisfactory" level of search for alternatives and consequences is a function of other organizational demands on the necessary means.

But to look further at the social aspects of decision making we have to rely on our common experience and mainly on some unpublished re-

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[18] Cyert, Simon, and Trow, *op. cit.*

[19] Cyert, Simon, and Trow, *op. cit.*, p. 459.

search. Aharoni, for example, in studying decisions whether or not to invest abroad, concluded as did Cyert, Simon, and Trow, that the problem was by no means a "given."[20] In one chapter, "The Decision to Look Abroad," Aharoni attempts to determine what posed the problem initially. To a significant degree he found the decision to look abroad was a result of *initiative from the environment;* a proposal from a foreign government, a distributor, or a client; the fear of losing a market; the band wagon phenomenon of following the lead of successful competitors; or the stimulus of competition from abroad. Realistically one might go even further than Aharoni in stressing the "semi-accidental" role of initiative from the environment. This, however, is only a part of the picture.

In another study involving the social aspects of decision making in a congressional situation, Pool, Dexter, and I found that a basic decision which every congressman makes is what kind of a congressman he will be.[21] There are a variety of ways of defining the congressman's role: formulating and working for legislation, servicing constituents, being a spokesman for local interests, delivering legislative criticism, serving on investigating committees, serving his party in an organizational way, and so on. Because of the limitations on his resources and energies, no one congressman can play all of these roles to the hilt.

The business executive, similarly, has latitude in defining the way in which he will carry out his role. As a matter of fact because of the intolerable range of things he could do, he must establish a distinctive definition of his own role.[22] This, in turn, determines where in the organization certain problems will be handled, whether in fact certain problems (for example, some forms of investment opportunities) are considered at all and whether, if they are considered, they are handled deliberately, impulsively, or even by default.

If we assume that our congressional model has general applicability, the role which the man chooses to play encourages certain communications and discourages others. Thus, the man affects the probability of certain *types* of problems being brought to his attention.

In Aharoni's study, for instance, an important factor was the involvement of some high official of the company in international affairs. Since the main body of investment opportunities concerned Israel, this meant that the involvement of officials in the Jewish community became a specific factor. However, while a man may affect the range of problems brought to his attention, the environment itself exerts a good deal of influence on which specific problems are raised. Furthermore, by virtue of a man's established relationship to the sources which bring problems to him, he is committed to take such problems with relative seriousness.

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[20] Yair Aharoni, "An Analysis of Decision-Making Processes in Foreign Investments" (unpublished doctoral dissertation, Harvard Business School, 1963).

[21] Raymond A. Bauer, Ithiel Pool, and Lewis Dexter, *American Business and Public Policy* (tentative title) (to be published by the Atherton Press, 1963).

[22] Cf. Carroll L. Shartle, *Executive Performance and Leadership* (New York: Prentice-Hall, Inc., 1956), pp. 90 ff.

Some descriptions of decision making do not assume the problem is a "given" in a simple sense, but emphasize the fact that the problem has to be "defined." This "definition of the problem" is taken as a clearly defined step, succeeded in turn by further discrete steps. Actually, of course, the "problem" often gets continuously redefined in the course of investigation. As a matter of fact, some problems proceed backwards in time, with a specification of the desired end product being stated shortly after the amorphous perception of a problem.

In Eyring's study of a research and development project,[23] the company proposed to produce a given type of instrument. He refers to this as "setting an objective." The "setting of the objective" was in itself a social process of bargaining between the company and the contracting agency, with respect to performance, time, and cost. Actually, neither party knew very precisely what was required nor what was possible. Thus, the "objective" became "the problem," and one of the salient features of the problem-solving process was the constant redefinition of the objective as work progressed.

As this suggests, clearly, some of the steps in the sequence often get inverted. Planning in this case was done to a large extent backwards, with the participants estimating the amount of time necessary for the last step before the deadline. This gave the limits within which they could perform $n - 1$ steps. The limits on the next to last step were then estimated, and so on. The result was that by the time the search process started, the time limits within which it could be conducted were already fixed. Therefore, it was necessary to accept the best estimate available at the end of that time. As a result, in each step of a highly successful project, only a very limited range of the possible alternatives were ever actually considered.

This constriction on the range of possible alternatives seems to be customary. Aharoni found that individual investment opportunities were considered "on their own merit," rather than as one among many alternatives. It might be argued that the allocation of resources to each investment was considered as an alternative to all other possible uses of the same funds. But there is nothing in Aharoni's findings to suggest that this was done in other than the crudest fashion.

For example, a very early step in the decision process was to screen the proposition for "riskiness." The businessman under study possessed a concept of what was a "reasonable risk." This led them to reject those propositions which did not meet this criterion, even though some of the propositions rejected (based on Aharoni's knowledge) promised a rate of return on investment that would have warranted even the most extreme risks according to the established way of thinking about such decisions. But, since the screening for "riskiness" took place *first,* the calculation of rate of return never took place.

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[23] Henry Eyring, thesis research in progress on the role of normative planning models in relation to actual behavior.

There are other ways in which the "normal" sequence of decision making is upended. Often, in effect, the solution actually precedes the recognition of the problem. That is to say, by virtue of their histories, organizations and individuals have "preferred" solutions resulting from acquired skills, habits, and information. In Eyring's study, limitations of time, cost, and other resources for information gathering caused the information already accumulated in the heads of the decision makers to give a strong cast to the early steps of the investigation.

Now in a sense, I would like to reverse direction. Up to this point I have argued that *actual* problem-solving behavior concerns itself with a smaller range of alternatives and consequences than the usual model would suggest. But, on the other hand, abstracting the process from its organizational context also restricts the range of consequences with which the person is *actually* concerned, specifically those consequences which stem directly from the decision maker's membership in the organization.

An example is afforded by the concern felt by Gerald Simon's space buyers for handling their relations to clients and colleagues. Another illustration came to light when Pool, Dexter, and I did our study of the congressional consideration of the Reciprocal Trade Act in 1954–55. Here we found congressmen for whom this legislation posed one or more of the following additional serious problems: delegation of powers to the executive, conflict between local and national interests, personal loyalty to congressional friends who were in a difficult position, rights of free speech (should there be debate on the floor of the House), and preservation of the House's working traditions (no open debate on the bill).

Not only does considering the problem out of its organizational context obscure the range of issues with which the principals are concerned, but it isolates it from the other activities in which people are engaged. To some extent this means doubling back on our tracks and talking about the allotment of resources to the resolution of the problem. But I believe something more profound may happen. Depending on the other ongoing activities of the organization, a given problem may be handled in drastically different manners. For example, a problem may come along with which a given executive might ordinarily be vitally concerned. However, at this particular point of time, other issues are more important. Under these circumstances he follows a deliberate strategy of making concessions on the problem in question as a way of gaining cooperation for the pursuit of more important objectives.

The importance of *formal* decision-making mechanisms (as contrasted with the less ordinarily considered factors I have been discussing) in a business organization is well recognized. But the usual treatment of this topic is excessively dogmatic, with a strong emphasis on the "right" and "wrong" ways of doing things. An interesting *behavioral* treatment may be found in Walter's study of investment decisions by insurance companies.[24] He shows how variation in the size, organization, and functioning of the decision apparatus leads to the consideration of different sources of loans, and to somewhat different outcomes.

The foregoing reference to the formal decision-making apparatus, though brief, is an acknowledgement of the importance of such factors. This is to offset the possibility that my concentration on less formal, less usual considerations constituted indifference to formal organizational features.

Now that I have already complicated things enough, I would like to suggest to the reader that there are times when the word "commitment" is more appropriate to what goes on than is the phrase "decision making." As a result of all the activities in which the individual is involved, the activities of other people in the organization, and the unanticipated consequences of all these, the supposed decision maker may find that in reality the decision has already been made for him.[25] To recognize that this is the state of affairs is often no trivial intellectual feat. To quote Becker's eloquent statement of the process:

> . . . through a series of acts no one of which is crucial but which, taken together, constitute for the actor a series of side bets of such magnitude that he finds himself unwilling to lose them. Each of the trivial acts in such a series is, so to speak, a small brick in a wall which eventually grows to such a height that the person can no longer climb it. The ordinary routines of living—the daily recurring events of everday life—stake increasingly more valuable things on continuing a consistent line of behavior, although the person hardly realizes this is happening. It is only when some event changes the situation so as to endanger those side bets that the person understands what he will lose if he changes his line of activity. . . .[26]

This is a possibility especially worth considering since it is ordinarily assumed that *important* decisions are made most deliberately and ordinarily with the least constraint of other considerations. But, this is not always the case. For example, it has long been a complaint of our State Department that the ordinary problems get explicit attention and overall policy is made by default. There is a familiar phrase used to describe this: "Policy is made on the wires," that is, in the cabled responses to specific problems arising in the field.

Aharoni regards the investment decisions he studied as occurring by some such process of commitment via the cumulative weight of small acts. "In general, therefore, it was virtually impossible to find out at what point, and by whom, was the conclusion to invest made."[27] How different from an orderly decision model were the events depicted by Aharoni.

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[24] James E. Walter, *The Investment Process* (Boston: Division of Research, Harvard University Graduate School of Business Administration, 1962), especially chap. vi, "Communications Flows and Incentives."

[25] For a systematic statement of this notion see Howard S. Becker, "Notes on the Concept of Commitment," *American Journal of Sociology*, July, 1960, pp. 32–40.

[26] *Ibid.*, p. 38.

> 1. Word would circulate in the Jewish community that X was considering investing in Israel. This would grow into a source of substantial social pressure if the decision process was prolonged.
> 2. Within the firm X would find himself identified with the desire to pursue the investigation. By virtue of having fought for the investigation, he was semicommitted to a positive conclusion.
> 3. Suppose the company were in the export business. This constituted a commitment to stay in "foreign business," and therefore to invest in a given country if it became difficult to export to that country.
> 4. Or, men did not realize that money spent on investigation was a sunk cost that should not enter into their future calculations. Instead, they talked like this:
>
> "You want to protect your initial investment, so you continue . . . by that time you are stuck and have to go on. You have spent $25,000, and do not want to lose it, so you invest another $10,000 to continue the negotiations, and then you are in even deeper."[28]

In addition to one's own "side bets," one's compatriots continuously make such side bets for him. Eyring, in his study of an R. and D. project found that as the program progressed each man was making "decisions" which were in effect commitments for each of the others. A man who was working on a particular piece of the job would regularly find the range of relevant alternatives drastically restricted, or even reduced to one "choice" by the activities of his colleagues.

Nothing said here is intended to deprecate the importance or desirability of the use of human intelligence in solving problems, even if the individuals in question happen to be members of organizations. Nor does this pretend to be a complete or systematic treatment of the social and organizational features of problem solving. Like many of the previous sections, this one is intended to alert the reader to a range of issues and to offer him enough illustrations, hopefully, to set him thinking along similar lines.

VIII.

Restatement of Intentions

The intent of this chapter has been to help the student deal with the human data of business cases. The simultaneous advantage and disadvantage of the classroom and scholarly study is that they allow us to think about problems in peace and quiet without having to conduct a hand-to-hand combat with a very busy environment. Furthermore, the classroom shields us from allowing our emotions to become too vitally involved in the decision at hand. Hopefully, this academic practice will develop the capacity for analysis to the point that it becomes relatively automatic, so that we will not be too drastically crippled when we are in the real world of action.

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[27] Aharoni, *op. cit.*, p. 159.

[28] *Ibid.*, p. 75.

The major thrust of the chapter was to distinguish among: (*a*) the complex and sometimes seemingly confused way things actually happen; (*b*) the way we think things ought to happen; and (*c*) the way in which we as analysts of behavior would like to dissect and reassemble them. In truth, relatively little attention was directed specifically to the third point of how we as analysts and policy setters should act, except as the habitual intellectual habits of scholars have been identified as a source of confusion about things in the real world. But it could be argued on the other hand that the effect of the discussion of the way things actually happen cannot help but be a directive as to how cases should be analyzed and discussed.

In any event, the discussion of how people actually solve problems in a busy organizational setting is not offered as a model of how the student should conduct himself in the classroom.

New categories of relevant events, new variables have been introduced as the usual stereotyped model of decision making was dissected. The introduction of such new concerns often conveys the sole message "things are complicated." In fact, while convincing the reader that the old model had its faults, it may leave him with the impression that things are not only complicated, but chaotic and unordered. Of course, I have made efforts to avoid these unfortunate results. The intent of the entire chapter, it may be recalled, is to indicate that in fact things are *less* chaotic than they may at first glance seem; that the "irrational" has a rationale. The reader has been enjoined to look for the functionality and dysfunctionality of behavior in the context of *various* systems to which the behavior may be relevant; to search for the "decision rules" and favorite "policies" whereby the intellectual process is simplified; and to look at the social context in which the intellectual processes take place. In this way, it is hoped, the world of human affairs will appear to have more rather than less order and predictability.

Obviously, not every case will permit more than a fractional application of the complex model that has been implied in this discussion. It is hoped, however, that from time to time, if the approach proves congenial, it will shed some light where there was mostly darkness. Nor is so elaborate a way of looking at things always warranted even when the data are available. The analyst is always responsible for deciding how elaborate a model he needs to handle a given problem. If he should find a group of people acting in all situations like the utmost stereotype of economic man, then the analyst would be ill-advised to complicate his life by introducing additional variables which help him not at all.

Because of the finite nature of our knowledge, the *full* consequences of *any* policy are in principle unpredictable. On the other hand, if they were not also partly predictable, we could not perform even so simple an act as to walk across the floor. (Imagine how chaotic things would be if we could not make a confident guess that the floor would hold us up.) Regardless what our conception of ultimate reality may be, all of us act for practical purposes in a partially determinate world. This fact, in turn, points to another of the major limitations of a classroom situation. The student does not have to, in fact cannot, live with the consequences of his decisions. In the actual business situation he will find that decisions are not discrete events which come to a convenient end. They are merely the beginning of a new stage in an ongoing process.

An integral part of a wise policy is a system of "feedback," since no policy, no matter how wisely conceived, can fail to produce some consequences other than those which were intended. A pessimistic way of stating this might say that one of our most important activities is discovering in time the new problems we have created for ourselves by our solutions to the old problems. The use of such an information system itself presents both emotional and intellectual problems. On the one hand we find ourselves somewhat unhappy by facing up to the news about the difficulties we have caused ourselves. But, having gotten the bad news we then tend to react as rapidly as possible, sometimes too rapidly, to change things. Policy making in practice is not a detached intellectual practice; it is like piloting a boat in a maelstrom. No matter what your last move was, you will be forced to make corrections, all the while knowing that oversteering will swamp the boat.

part I

PLAN

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Prince Candy Company[*]

In June of 1931, Mr. Thomas R. Knight[1] graduated from the Alabama Polytechnic Institute (known as Auburn University) as a mechanical engineer. Jobs were not plentiful and after a few jobs which offered no career possibilities, Mr. Knight bought the Prince Candy Company, a small manufacturer of "candy-bin" candies, for $500. Not only was Mr. Knight owner, president, and production manager of the company, he actually performed a number of the operations involved in candy making in order to survive. Through hard work and very close attention to details, Mr. Knight was able to develop additional customers and the business grew, though quite slowly.

In 1936 Mr. Edward Lowe Johnston, also an engineering graduate from Auburn, who had later received an M.B.A. degree from the Harvard Graduate School of Business Administration, bought a half interest in Prince. Together they operated the company until Mr. Johnston was called to active duty in 1942. In 1946 Mr. Johnston returned from military service and resumed his duties with Prince. Early in 1950, in order to protect their personal estates, the partners incorporated and through the years continued to build up the business to such an extent that in 1961 sales of candy amounted to one and a half million dollars.

Mr. Knight and Mr. Johnston have been more than normally active in the operation of Prince (the work week of each is in excess of 50 hours and often exceeds 60 hours and each has explored new market possibilities as well as the introduction of new candy items. Most of the products are sold to variety stores for resale at candy counters. Typical customers included five and ten cent stores, department stores, and drugstores. The Prince Company constantly added to its product line with the result that currently they sell 110 candy items. The best selling item is Peco Flake, a peanut and coconut-chip mixture bonded in a firm caramel-like candy. In 1961, sales of this item amounted to more than $225,000.00 (slightly more than 15 percent of total sales), and among members of the National Confectioners Association, Prince is recognized as having the finest Peco Flake in America. Prince packages many of its products—particularly peanut brittle—in cartons bearing the label of the retailer, and has developed a significant amount of business of this type.

To the casual observer, much of Prince's production equipment appears worn out and obsolete, yet production delays due to inoperative equipment are very rare. Mr. Johnston has used his training as an engineer to advantage and has designed much of the equipment. With the help of Mr. Ed Voyles, maintenance engineer, he has built much of the packaging and cooling equipment. Together, they have maintained all the equipment in excellent operating condition. More modern machines are available, but these are priced out of reach for a company as small as Prince.

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[*] Prepared by James E. Chapman, Georgia State College.

[1] Company name and names of all employees have been disguised at the request of the company involved.

In many ways, Prince has a relatively unique situation regarding its production. There are 65 production employees of whom 40 are Negro men, 24 are white women, and one white man is employed as a candy maker. Most of the women are involved in operations concerned with packing the candy and the Negro men are employed primarily in the manufacturing and shipping operations under the direction of Mr. George Burns, the production manager. The women are for the most part middle aged or older and possess relatively little educational background. Most of the Negro men are past middle age and have been with the company for 10 to 20 years. A few of the younger Negro men have high school educations, but many of the Negroes are illiterate. Despite educational limitations, however, these men, under the personal leadership of Mr. Johnston and Mr. Burns, are quite adept at improvising ways for determining the proper proportions for the mixing of formulas. For example, one of the oldest Negro men, named Spud, is quite skillful as a batch maker and is able to mix the proper ingredients by etching certain lines on the inside of the big candy pots to indicate the amount of each ingredient to be poured in. Another oddity in the Negro work force is that most of them have done nearly all of the jobs in the plant and thus possess a great deal of flexibility in assignments.

Mr. Burns, after consulting with the clerk who handles sales orders, determines each afternoon the type and amount of each candy to be prepared on the following day. He then draws up work assignments and posts them on the board in order that the various employees will know upon reporting to work the following morning just what their assignments are for the day. Despite the fact that many of them cannot read, each of them recognizes his name or nickname as it is printed up on the day's production schedule, and each goes to his assigned work place without additional direction from Mr. Burns. One is impressed, when walking through the plant, with the seriousness of purpose of these workers, both men and women, and the fact that there is virtually no horseplay. Furthermore, there is a relatively small amount of waste resulting from incorrect mixing, cooking at the wrong temperature, or other of the more usual problems encountered in the candy industry.

Prince operates five days a week and all of the white women packers normally work 40 hours per week. Most of the Negroes work 45 hours a week in order to have an additional hour each day for cleaning up the plant and finishing up production runs in order that there be nothing left uncovered overnight. A few of the senior Negro employees regularly work 50 hours per week in order to mix and begin cooking "batches" of candy before the other workers "punch in" each morning. In the main, the white women packers make $1.25 an hour and do not receive any overtime work. On the other hand, the Negro production workers receive base rates ranging from $1.20 to $1.40 an hour (depending upon ability and longevity) and most of them receive five hours a week overtime though a few receive 10 hours a week of overtime. In a very real sense, this plant has always been "integrated," for the white women work right on the production lines with the Negroes and the women who are in the air conditioned rooms, where temperature must be maintained below 70 degrees in order for candy to set up, work directly with the Negroes, who fold boxes and load the packed boxes on skids. Though it is generally correct to say that the women are the packers and the Negroes are the production workers, it frequently happens that the Negroes are placed with the women to help pack in order that there be no temporary layoffs. There seems to be little or no racial problem within the plant, and there has never been a reported incident of trouble arising from racial questions. The white women have a separate dressing room, and the colored men have a dressing room of their own. (The one white male candy maker does not dress on the premises.) Furthermore, there are two water fountains on the main floor, and though there has never been any directive to this effect, the white employees use one and the colored men the other. All in all, there is an air of good fellowship in the production and packing activities, and the two classes of workers seem to accept each other quite well.

Without question much of the credit for the success of Prince has been due to the philosophies and policies of Mr. Edward Lowe Johnston, the secretary and treasurer. Bob Ford, the purchasing agent, says about Mr. Johnston, "He is undoubtedly the finest man I have ever met, and he has the greatest ability to work with people of anyone I have ever encountered. He is a real gentleman and knows each and every employee in the plant and is directly interested in the well being of all of them."

George Burns, the production manager, says of Mr. Johnston, "It has been a revelation to me to have the opportunity to work under Mr. Johnston. When I came here, I was accustomed to driving the production workers in the candy plant where I had been working. Mr. Johnston insisted that I give up these authoritarian tactics and employ more human approaches to leadership. He is a man of great compassion and he insisted that I learn to accept the limitations of our less fortunate production workers and do everything within my power to teach them to operate within these limitations and to keep a careful record of the accomplishments and skills of each person in order that he be upgraded as much as his basic abilities would permit. Though I did not receive a college education myself, I feel that I have had a very liberal and humanizing educational experience by virtue of my association with Mr. Johnston."

The employees of Prince have never been represented by a union, and

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the most senior of the employees have expressed a strong feeling against being unionized. Prince does not maintain a fleet of trucks, but does nearly all shipping via commercial motor carriers. Nonetheless, a representative of the Teamsters' Union approached the workers in 1959 and obtained enough employee signatures to request that an election be held to determine if the majority of the employees wished to be represented by the Teamsters' Union. At that time there were approximately 55 employees, and the vote clearly indicated that they did not wish a union representative—at least not this particular union. From 1959 to 1962 business continued to improve and several new employees were hired. Early in 1962, the Teamsters' Union again began an organizing campaign with the workers of Prince and once again were able to secure enough signatures to request an NLRB election to determine if the union might be named as the representative for the employees. The owners of the business quite frankly admit that they do not want to have a union in the plant but nonetheless exerted no overt action to defeat the union in either of the two elections. In 1962, the union was defeated by a vote of 34 to 30. The owners of the business were quite perturbed over this turn of events, for they had felt that the workers were "more loyal" than was indicated by the vote.

In trying to determine what had brought about this change of attitude on the part of the workers, Mr. Johnston called a meeting of the executives of the company and asked for suggestions and comments. His line of reasoning was that though the union had been defeated, the vote was so close that it was very likely that the union might win a future election, and he was most concerned about this because of the promises that the union made to the workers in the campaign just concluded. For example, they promised the workers that if organized, they would receive "Chicago wage rates." Chicago is recognized as the candy capital of the United States, and the union told the Prince employees that their rates of pay would be in the neighborhood of $2.00 per hour for straight time once the union became the representative of the employees. Furthermore, the union attempted to create the feeling in the minds of the Negro employees that they are being discriminated against, despite the fact that they are being paid more than the white workers. They made much of the fact that the white women have a separate dressing room and that the white employees drink from one fountain, the colored the other. Mr. Johnston opened the meeting by reviewing the various fringe benefits that have been given to the employees over the years. (Each of these benefits is paid for entirely by the company and each has been added by the company "on its own" with no pressure being brought by the employees.) Mr. Johnston said, "Our present fringe benefits include the following:

1. *Life insurance policy.* Every employee who has been on the payroll for four months following June 1, or December 1, is provided with a life insurance policy as indicated below, paid for in full by the company:

$500—women and lower paid colored employees.

$1,000—colored employees consisting of cooks, candy makers, batch makers, etc.

$3,500—all office and executive personnel.

2. *Vacations.* Employees with less than six months' employment—no vacation. Employees with six months' but less than one year's service, one week paid vacation. Employees with more than one year, two weeks' paid vacation (women employees based on forty hour work week; men based on forty-two and one half hour work week). Employees who are entitled to one week of paid vacation, or who have no vacation entitlement are allowed to do "clean up and repair work" during the two weeks in July when the plant is closed for vacations, in order to suffer no financial loss.

3. *Bonus.* Mr. Knight and I determine the availability of funds and give a Christmas bonus to each employee. For the past several years this sum has been $60 per person.

4. *Profit-sharing plan.* In order to participate an employee must have been employed a full year as of August 1, of a given year, the customary time for distributing profits. At present and for several years past employees have been given a profit-sharing bonus of 5 percent of the salary earned the previous year.

5. *Laundry.* Though most candy manufacturing companies do not provide uniforms or cleaning, Prince furnishes uniforms and pays for the cleaning of them.

6. *Paid holidays.* There is no legal requirement for doing so, but Prince gives a paid holiday to each employee on New Year's Day, 4th of July, Labor Day, and Thanksgiving. The afternoon of the last working day before Christmas is devoted to a company party at which time we distribute the Christmas bonuses and the Christmas gift baskets. (As you know, Mr. Knight and I long ago inaugurated a policy of giving each production employee a basket of food stuffs including fruit, groceries, meat and eggs at Christmas time. The approximate value of this basket in recent years has been $15.00, all baskets containing identical items.) Thus the employee has one and one half paid days off for Christmas, and if Christmas falls on Monday, Tuesday, Wednesday, or Thursday, we give everyone a paid holiday for the day after Christmas.

7. *Loans.* As is so often the case, employees of the lower socio-economic group find themselves with financial emergencies which are virtually insurmountable. In an effort to tide the employees over unusually rough financial spots, the company has a loan fund and charges no interest on the loan. (More will be said about the loan fund after an enumeration of other fringe benefits.)

8. *Compensation when an employee is injured.* If a worker is hurt on the job, Prince pays him for all time (usually one week) until workmen's compensation payments commence.

9. *Security of job.* Prince has been most forward in its thinking about workers who have been ill or disabled. For example, over the years several employees have been institutionalized for the treatment of active tuberculosis. In each case Prince has maintained contact with the employee while in the sanatorium and has returned him to his job as quickly as medical authorities have approved resumption of activities and renewed his health card.

10. *Miscellaneous.*

a) The candy business is highly seasonal and most companies operate at peak capacity in the fall and winter and lay off workers in the spring and summer. We maintain steady, year-round employment with no labor fluctuation, and it is costly. For example, during our peak season in the fall a packing crew (consisting of two candy dippers, two packers and one half caser [caser serves two lines simultaneously]) will pack 155 cases of peanut clusters per day. At other times of the year, a crew will normally pack 102 cases per day. Our studies indicate that 150 cases per day should be the standard output, but the workers "soldier" except in peak seasons.

b) Prince maintains two pickup trucks and we lend these to employees who are moving to new residences.

c) Over a year's time, many of our employees are arrested on "drunk and disorderly" charges. At such times, we "go their bail" and lend them money to pay their fines if they ask for such help.

d) We give the women two ten-minute coffee breaks a day, but since we can't shut down the candy making, the men take their breaks as production processes permit, and I feel sure they are away from the work area much more than the women.

Let me conclude with a few more words about the employee loan policy which was originally intended to help employees who had been garnisheed for failure to meet financial obligations. It has expanded considerably beyond this point and though there is no official policy, each employee who requests money is given every consideration. Originally, no attempt was made to verify the authenticity of loan requests. This resulted in a plethora of requests and Mr. Burns, the Production Manager, was given the task of administering the loan fund. Though Mr. Burns has no written policies to govern his actions, he considers each request and tries to determine the authenticity of the alleged need. If a loan is granted, no interest is charged and the repayment schedule is determined by Mr. Burns and the applicant. Many unwarranted requests for loans are made, but overall, the fund has served a real need. For example, a present employee borrowed $50 in order to help his mother whose kitchen had caught fire and burned. In this case no proof was requested as to the validity of the need. Another long term employee, a colored man, needed money in order to have a corrective operation performed on his wife, who had borne him fourteen children. She needed a hysterectomy and Prince lent him $750 in order to pay for surgical and hospital fees incurred in this operation.

Recently an employee asked to borrow $75 in order to pay for funeral expenses for his wife who had, so he said, been killed in a highway accident. The employee pointed out that Negro funeral companies will not extend credit and must have the money in advance in order to assure burial. Mr. Burns checked with the state patrol and could find no record of an accident of the type described by the employee. He next called the local police department and again received a negative report. At this time he called the undertaker who was allegedly embalming the cadaver and the undertaker said that he had no knowledge of any such person. Mr. Burns called the employee in to tell him that he could find nothing to substantiate his request and the employee laughed and said that his wife had been arrested for being drunk and disorderly and had been fined but that it had been taken care of and indicated no desire for the loan at that time. Many instances of this type are on the company loan record book.

After a recital of these fringe benefits, and the type of conditions which surround employment at Prince, Mr. Johnston indicated to those assembled that the Teamsters' Union had filed a protest on the recent election claiming the following irregularities:

1. That the company had permitted two employees to vote though it was obvious that these employees were under the influence of intoxicants.
2. That in mid-May, during the organizing activities, the company had given each employee a five cents an hour raise in an attempt to sway the vote.

3. That Mr. Burns had made a statement in the presence of some of the colored employees to the effect that they'd lose their jobs if they voted for the union.

JOHNSTON (*Continuing*): Gentlemen, this last election was much closer than any of us expected, and it indicates discontent on the part of the employees. If a re-election is held, we may not be so fortunate. Perhaps some of you have ideas as to why the willingness of our workers to organize has changed. If so, I should like to hear your views.

BURNS: Mr. Johnston and gentlemen, I believe that the labor election is a result of the hiring of additional young colored men. Many of them have high school educations and due to studying sociology in school are highly concerned with the general advancement of the colored people. I'm in closer touch with the workers than anyone else, and I can almost guarantee that all the women—with one or two doubtful cases—voted against the Teamsters.

FORD: I agree with George, and let me indicate the kind of thing that is going on. You all know Fred [Fred Haynie, an illiterate colored man who had over 20 years' service with Prince]. He has been an informal leader of the colored people for years and he has always advised them against unionism. However, his oldest boy is working on his Ph.D. degree up North, and right before the last labor election Fred told some of the men that his son felt they should vote for the union, and his voice carried, in my opinion, a great deal of weight. My guess is that we have about twenty to twenty-four women who voted against the union, one white man, and eleven to fourteen Negroes. This leaves twenty-six to thirty Negroes and one or two white women who probably voted for the union.

KNIGHT: Bob, why do you feel so certain that the women are with us?

FORD: Mr. Knight, those women are generally not employable in other industries. Some of them are very slow and resist new work methods to a great extent. Further, they are generally past middle age and realize that they have a good thing here at Prince.

JOHNSTON: Gentlemen, as you know, Prince is a small business as businesses go, and we operate with very low overhead and administrative costs. We pay our workers, almost to the man, more than they can get in any other employment, and we treat them well in every respect. At least I think we do. Can anyone suggest ways by which we can improve "human relations" in the plant? (No answers.) Well, you know as well as I do that we could not operate if we were forced to pay union wages. . . .

BURNS (*Interrupting*): Mr. Johnston, we all know that this problem exists in the plants of all our competitors. We're paying as much or more than any of them, and I feel our success has been due to the very personal interest we have shown in each of the workers. I don't know what those guys expect—if it weren't for Prince, most of them would be day laborers or else on relief!

JOHNSTON: I believe that is true, George, but it doesn't solve our problem. Larry (Larry Whitworth, vice-president in charge of sales), is there any likelihood of increasing sales?

WHITWORTH: Mr. Johnston, we're operating "over our heads" now. As all of you know 96% of our sales are to customers east of the Rockies, 3% west of the Rockies, and 1% to Mexico and Canada combined. Additional sales, in my opinion, could only be had through direct representatives and would not be profitable.

JOHNSTON: Walter,[2] could we "crack" the fancy candy market?

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[2] Walter Emerson, a candy making expert, author of the best-selling books on candy making. Emerson is a part-time consultant to Prince, and is paid only $1,200 annually in order to draw full Social Security payments. He is past retirement age, but is, in Mr. Knight's opinion, the "world's best candy maker."

Emerson: Ed, we've been through all that before. We don't have the equipment or the personnel for making fancy candies. On our bulk, candy-bin products, it doesn't matter if the sugar is two or three pounds over or under on a 500 pound batch, but it would make a difference if we were trying to compete with Russell Stover, Whitman, Nunnally, or Norris, for the "carriage trade" is more discriminating. Our people can't read recipes, and they have to be taught "rule of thumb" methods for batch mixing. Furthermore, we'd have to have a larger plant and more expensive equipment—specifically, our chocolate enrobing machine would not be adequate—if we tried to manufacture fancy candies.

Whitworth: Mr. Johnston, Prince is known all over the U.S. as a dependable supplier of candy-bin items, but we would have a hell of a time trying to enter the fancy candy field. Most of our present customers buy no expensive candy, thus we'd have to start from scratch in a highly competitive field.

Johnston: Gentlemen, from what you've told me plus my knowledge of Prince's assets, I could only conclude that our choices are two: (1) continue to operate without a union; or, (2) cease operations. I propose that we think this over for a week and then meet to discuss legal and ethical ways to cause our workers to vote with us. Let me tell you that in my view the thing that helped us most in the last election was a talk Mr. Jess Walker made. As you know, Mr. Walker is a Negro lawyer of wide repute who is very active in local and national organizations of colored people. When he heard of the impending Teamsters' Union election, he called and asked if he could talk to our people. He came over and was very outspoken. He described the Teamsters' Union as one that has been investigated by the Senate for alleged graft and corruption. He told our men that they'd be hurt more than helped if they should elect to be represented by the Teamsters. There is no doubt in my mind that he saved the day for us, and I feel that other responsible Negro leaders would tell our people the same things that he did. At any rate, you know the facts and the problem. Please write out your suggestions for the staff meeting to be held next Tuesday at 2:00 p.m. in this office.

Southwire Company[*]

I.

It is the very nature of a private property, free enterprise economic system that every year a multitude of dreams are born. The dreamers are men and women who, attracted by the lure of personal achievement, service, and profit, hope to "go into business for themselves." Feeling stultified within the bureaucracy of some other organization, seeing the need to produce some commodity or perform some service that is currently being inadequately supplied, or challenged by the thought of being independent businessmen—these people give thought to risking the heartaches and uncertainties of entrepreneurship.

And of course in many cases giving thought to such a step is as far as it goes. Dreaming is a very inexpensive and trouble-free way of going into business for oneself. But when one begins to talk to one's associates about "making the break," most of whom are by definition more conservative than the person who would think seriously about exchanging a fixed income for a residual one, the rosy glow of anticipation is apt to cloud a little. Moreover, if this thinking goes as far as actually sounding out a few of the basic facts of life concerning the decision under consideration—things like financing, labor supply, and occasional years without profits—it is all the more likely that doubts will begin to rise.

Nor does it follow that if a dream survives to the point of actual planning it will necessarily become a blueprint. The process of reducing general understandings to specific agreements presents additional pitfalls. Terms imposed by financial backers have a way of looking fairly harsh when committed to a piece of paper. One or two key people who had been heavily counted upon may be the ones to get cold feet at the last minute. Some critical variable, which had seemed at least tolerably favorable when viewed in perspective will sometimes show up as clearly adverse in the face of detailed calculations. Personal factors, such as, for example, a death or a serious illness within the immediate family, may intervene.

By the same token blueprints do not automatically become plants; again there is many a slip 'twixt the cup and the lip. A wife who has tried to adjust to the possibility of a period of hard times of uncertain duration may find that when the chips are down she cannot permit her husband to do this to his family. Two or three rival concerns, perhaps even new ones, may pre-empt the opportunity to be exploited before plant plans have actually been launched. A change in the economic climate, most notably a painful drop in aggregate demand, may make this year an inopportune one to launch the proposed venture—and of course it is not to be taken for granted that a blueprint once laid aside will ever again be of more than historical interest.

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[*] Prepared by Howard R. Smith, University of Georgia.

And even if all of these obstacles are overcome, it is not to be supposed that success is assured, for every year many thousands of new concerns fall into that dread abyss called bankruptcy. Dreamers and planners do not necessarily make competent entrepreneurs and administrators. Errors in planning may not show up until production gets underway. More money than contemplated may be essential to success—but be unavailable. The business cycle often smiles on a plant that is building, only to frown treacherously upon it once funds have been irrevocably committed. Discouragement may remove one or two highly important persons whose support for one or two more years would have just made the difference.

All of this—dreams which do not in all cases become blueprints, blueprints which may or may not become plans, plans which miscarry and those which do not, plants which may not live through their period of infancy and concerns whose very existence year after year provides eloquent evidence of their vitality—is the stuff that free enterprise is made of.

II.

A going concern possesses tangible resources and meticulously kept records which literally command our attention; by contrast a dream is vividly real only to the person who has it, and can be only vaguely communicated to another. Even concerns which do not survive often leave behind them so wide a trail of litigation that they too can readily be studied; the early planning that goes into a prospective new enterprise, on the other hand, even when committed to paper, is very likely to disappear—either because the promulgators of plans which do not bear fruit prefer to accentuate the positive, or because where success does come the projections of the planners soon seem much less significant than historical records.

Unfortunately, however, this procedure of determining emphasis on the basis of the accessibility of information has serious shortcomings. The fact is that, because the vigor of a free enterprise system is fundamentally dependent upon the birth and rise to maturity of new concerns, one of the most crucial policy decisions which can be made is whether or not to bring a new enterprise into existence. More specifically, from the standpoint of challenging students to think through a complex business situation, this type of decision has the tremendous advantage of highlighting important relationships which the study of going concerns has the effect of taking for granted.

For example, the key to an understanding of a going concern may be what goes on within the minds of men and women before the first really tangible steps toward organization are taken. An idea may die in the later stages of evolution primarily because the initial resolve was not intense enough or because the enthusiasm of its launching was not adequately balanced by the hard thinking required to achieve the needed proportioning of means to ends. And of course by the same token a brain child may mature when all logic points to the hardest kind of sledding solely because the promoters are so thoroughly determined.

Stated a little differently, it is appallingly easy in discussing a business policy case to become carried away with analysis of ratios, market potential, incentive wage rates, and so on, and hence to overlook the importance to success (or failure) of the human factor which from the very beginning becomes its very heart and soul. Nor does this mean that all the human qualities necessary for success must be bundled up inside the same skin; they may be the possession of several people—provided only that these different personalities do not conflict too sharply. (And, indeed, avoiding this kind of conflict is often one of the most difficult problems a business concern has to contend with.) Whatever the distribution of qualities among various individuals, however, it is broadly possible to delineate some of the human characteristics which are most vital to organizational health.

Thus there must be an imagination capable of envisioning the outlines of a going business concern while it still consists of nothing but "brain waves" or at most scribblings on a piece of paper. Imagination must be liberally intermingled with the boldness which alone makes possible the seizing of opportunities as they fleetingly pass by. Boldness and imagination must in turn be supplemented by the firmness which assures that decision once made will be vigorously implemented—rather than haphazardly adhered to because "maybe we should not have done this after all." At the same time, however, firmness must be kept harnessed to just that degree of flexibility of outlook which enables the manager to adjust his operation to the ebbs and flows of business tides known as economic dynamics. And of course all of these qualities would in the event be seriously dissipated if not backstopped by the patient day-by-day administration of the firm's affairs which alone can efficiently transform raw resources into salable finished goods.

These few paragraphs suggest the rationale behind this excursion into what would seem to be something of an innovation in the writing of business policy cases. The innovation itself takes two forms. Perhaps most important, the case which follows is carried through only to the point at which a final decision as to whether or not to launch this enterprise is about to be made. Instead, in other words, of posing for the student a question of policy alternatives confronting an established business concern, the problem here is to determine if an enterprise which exists only in the minds and aspirations of two men should or should not be established. And second, because at this stage in a firm's life in particular the character of the principals is so decisive, a much more than ordinary emphasis will be centered on the men themselves.

III. THE INDUSTRY

First, a look at the larger industry framework in which this firm, if launched, would hope to find a place. Most broadly it would become a part of the metals industry, using as its principal raw materials copper, aluminum, and steel. More specifically it would belong to a relatively smaller segment of the metals industry termed by the Bureau of the Census "Wire and Wire Products." And narrowing its area of intended specialization still further, it would be a manufacturer of electric wire and cable.

Of these three basic raw materials, copper might perhaps be termed the most important. Certainly this would be true historically, although it might well be disputed for both the present and the future. In any event, the strategic importance of copper in the far-flung and complex electrical industry stems from its high electrical conductivity in proportion to its cross section and its price. And even though aluminum has recently become a major member of the electric wire and cable family there is no thought that copper is about to be replaced therein.

A key fact to keep in mind about a wire mill relative to the much larger copper industry of which it would automatically become a part is that a decision to manufacture copper wire cannot at all be the same thing as a decision to manufacture copper. There are a number of reasons for this. One of the most important is technological. The ore out of which copper is produced is far from pure, which means that as it comes out of the ground it contains a large proportion of waste. This in turn requires, because of the great cost of transporting long distances material which has no economic value, that copper processing and copper mining be geographically adjacent—which as a practical matter has always meant common ownership and operation.

And there is another dimension to this factor, too. It is a fact of much significance in this industry that copper ore is typically found in conjunction with other minerals which have commercial value (and of course the lower the copper content of the ore actually utilized the more important these other items must be). To be sure, these other minerals do not have to be sorted out of the basic ore, but it is obviously economical to make one processing operation accomplish as much as possible. Therefore a primary copper producer may soon find itself elbowed into lines it had no particular intention of entering. A case in point is The Anaconda Copper Company which has become over the years a major producer of a half dozen important minerals.

Closely related to these technological considerations are some financial ones. Because the preliminary processes are inextricably combined, because certain of these processes require vast amounts of power and/or electricity which can be economically provided only in very large quantities, and because its wire and cable uses account for only a small proportion of the total consumption of copper, it would be prohibitively expensive to go into these early stages of production for this use alone. And of course this conclusion is strongly accented by the added fact that the modern wire mill could as reasonably go into the business of producing aluminum as copper.

And turning all of this around we find that the actual structure of this industry is exactly reversed. Thus while we do not see wire mills mining and refining copper, we do see the concerns which mine and refine copper also drawing copper wire. As a result the concern which specializes in wire finds itself in active competition, in its own finished product market, with the firms from which it buys its raw materials—this relationship giving rise to what in the industry is referred to as the problem of the integrated versus the nonintergrated producer.

This pattern of relationships has a number of critically important consequences for the nonintegrated concern. First, it necessarily follows that some of the principal competitors of the latter will be incomparably larger than it can hope to be any time in the foreseeable future. To be sure, economic advantage is not all on the side of size in any industry—though integration does bring with it important benefits. At this point suffice it to emphasize only that the huge integrated concern has a decisive financial advantage as compared with its nonintegrated rival. Thus it can easily weather an economic downturn which would take out of the running the specialized wire mill, even though the latter was highly efficient from the standpoint of operating cost per unit. And bringing this factor to a more concrete focus, whereas a small mill might conceivably have sought to enter this business with a capital of $100,000 in 1950 (the approximate time which provides the setting for our case), in that year the footing on each side of the consolidated balance sheet of The Anaconda Copper Company stood at $700,000,000.

This purely financial advantage of being large can readily be illustrated in terms of one of the special factors which makes building one's livelihood around copper particularly treacherous. For one reason or another the price of copper is volatile, moving in narrow, sharp, and fundamentally unpredictable up-and-down cycles. At the same time the regularization of relationships with customers requires that finished goods prices be quotable well in advance of delivery. The result is that inventory price changes can be most burdensome at times, and a long siege of inventory "bad luck" can eat seriously into the thin working capital margin of the small operator.

In the second place, it is not a happy situation to be dependent upon a competitor for one's own raw materials; obviously an integrated competitor will not starve itself in order to supply a rival. To be sure, there is, fortunately, more than one primary supplier of this product, but during a period of raw material shortage (which would almost by definition be a period of high demand) probably every integrated producer would be jealously husbanding its own output. And note, in the third place, that the integrated and the nonintegrated firm stand pricewise in a markedly different relationship to the market for copper and its products. The former, for example, is not tremendously concerned with the price of refined copper by comparison with the price of copper in end-use form. If a high price for refined copper means low profits for a wire-drawing subsidiary, a large share of that misfortune will be offset by the profits earned in mining and refining. Not so the independent! The spread between these two prices is its bread and butter; out of it must be paid all costs and all return to investors. And of course a narrowing of this spread may mean an absorption of its profits, in effect, by its integrated competitors.

Moreover, these relationships have an even more subtle implication as well. Because the number of primary producers of copper is small by comparison with the number of specialty users of copper of all kinds, it is even possible for the former to exercise a certain amount of strategic, concerted control over the price of the basic raw material used by nonintegrated rivals. To be sure, if this is done carelessly, that is to say openly, the antitrust laws could intervene. But with only a handful of concerns involved, each having much to lose from a price war of any consequence, it is possible for tacit understandings to develop.

And of course the obverse of this fact is what really creates difficulty for the smaller, specialized firms. Because there are many of these, so many that tacit price understandings are impossible, and because these concerns also have high fixed costs which cannot be covered unless production is maintained at a fairly high level, they frequently find themselves pushing output onto the market even in the face of weakening prices. Where at one end of the market a few organizations are able to insure a fairly effective balance between supply and demand, thus keeping the price reasonably profitable, while at the other end of the market a large number of concerns are compelled to press their output into market channels at whatever prices prevail, it is likely that the spread between the price of primary and end-use copper will more often be narrowing than widening. (And since 1950, incidentally, this margin has in fact done a good bit of narrowing.)

And there is one other facet of copper industry price relationships which is of critical significance for nonintegrated concerns. That is the basing-point system of price making, some variation of which is so commonly employed by basic copper producers.

Copper in whatever form is a bulky product with a relatively low value per pound. This in turn means that its transportation cost is a proportionately large fraction of final selling price. Because this is such a compelling consideration, copper concerns do not ordinarily establish "postage-stamp" pricing systems—an arrangement in which delivered prices will be essentially the same over a wide geographical area. Instead, the system employed will typically be one in which the distance from point of manufacture will have an important bearing on delivered price. And in order to introduce some system into this necessity of varying price with distance the practice has developed of setting a base price at the mill, a price applicable to all customers, and then adding to that base the actual transportation cost from point of production to consumer warehouse.

Described thus briefly and hence simply, basing-point pricing sounds like nothing more than a straightforward way of dealing with a basic industry fact of life. But in actual practice it has turned out to be much more than that, for very early in its history it was discovered that it could be used to serve other purposes as well. For example, it soon became evident that, simply by converting some nonproducing point into a basing-point, or by taking basing-point status away from certain producing points, the basing-point system of pricing could be made into a powerful competitive weapon.

The possibilities here can be seen especially clearly in terms once again of the relationship between an integrated firm and a nonintegrated rival. Suppose the latter goes into business in a part of the country where it has a natural transportation advantage over a substantial geographical area. Starting, in its calculations with the price structure its integrated rivals have already established (and let's assume here in order to present this problem as decisively as possible that no points in the area to be newly served have heretofore been designated as basing-point), it will likely be simply taken for granted that the fledgling concern will have a natural price advantage in its own territory. But if one or more of its big competitors shortly made the new point of production a basing point in its own pricing system, that advantage could be summarily wiped out.

To be sure, the new concern would still have a transportation advantage on its own home ground. That is, a competitor muscling in on the new firm's nearby customers would have to pay out in freight a good bit more money to supply this business than would the smaller concern. But to a big operation with many sales areas this necessity comes under the heading of local price cutting to obtain marginal but nonetheless valuable business, and therefore the cost of freight absorption might well be considered as of no more consequence than an extraordinary outlay for advertising. In short, integrated concerns have not historically exhibited any compunction about absorbing freight to customers under the noses of smaller, specialized competitors.

And finally, because this "firm" was thinking of going into business in the southeast at a time when little wire drawing was being done in that part of the country, it is necessary to point up one other important aspect of copper transportation. The raw material out of which wire is most immediately made is a product known as copper rod—an item the brand-new concern would hardly undertake to produce for itself. Overwhelmingly the production of rods has been concentrated in the eastern Pennsylvania–New Jersey area, also one of the areas of greatest sales density for copper products in the United States. If a new concern endeavored to do some selling in the industrial east, and of course this would be only natural, it would consequently have to bear the double transportation cost of bringing rods to the wire mill and at the same time freighting finished wire products into the region where rod is manufactured.

Furthermore, because copper does not in any very real sense ever wear out, and because much scrap copper can be re-refined more cheaply than copper can be refined, primary copper producers utilize as much scrap as possible in their own operations. By the same token, our newly born wire mill in the southeast would have available to it a certain amount of scrap copper which, other things being equal, it could profitably assemble for conversion into rod. But this turns out to be not feasible for a specialist wire concern in the south because here again a double transportation cost would have to be borne; the scrap would have to be shipped to rod mills in the east, and from there back to the wire mill.

IV.

Viewing the industrial setting of a newly-launched wire mill only from the standpoint of the copper industry already makes it clear that such a concern might have a long and rocky road down which to wend its careful way. Moreover, when this view is broadened to include the other major raw material now used by such concerns—aluminum—it is evident that this possibility is even more likely.

For one thing, the use of aluminum in wire and cable manufacture is suggestive of the highly dynamic character of this process, a fact requiring considerable agility on the part of those who seriously expect to make money at this activity. Just prior to World War II, for example, aluminum was too expensive a material for this kind of use. As aluminum manufacture matured, however, its price steadily fell in relation to that of copper, until today it is the preferred base for many types of wire and cable products.

Then, too, a glimpse at some of these preferred uses gives a small insight into the complexity of the wire and cable business—another factor which greatly complicates the life of wire mill executives. Because a given diameter (cross-section) of aluminum wire will carry only about 60 percent as much electric current as will a copper wire of the same size, the latter must be employed in any use where space is an important consideration—as, for instance, inside the shell of a transformer. On the other hand, however, because aluminum is so light in weight relative to its cross-section, an aluminum wire capable of carrying a given amount of current will weigh only half as much per unit of length as will a copper wire having the same carrying capacity. And this, of course, means that where weight is a key factor aluminum cable has a decisive advantage. Thus where aluminum is used for cross-country lines carrying a high voltage, a considerable saving can be effected by setting poles substantially farther apart.

In structure the aluminum industry has much in common with the copper industry. Thus it too is initially processed by the same companies which mine the basic ore—and in the same vicinity. Here too, moreover, vast amounts of power (electricity) are required and wire and cable uses account for only a small porportion of total consumption—with the result that a small concern just entering the wire business would not seriously consider integrating all the way back to the mine any time soon. And as a consequence of all of these factors, the aluminum as well as the copper industry is made up of a small number of integrated, raw material producing firms in direct competition at the end-use level with a multitude of smaller, specialized concerns, the small firms here too running the risk of tightly rationed raw material whenever overall shortages threaten.

This being the case, it follows of course that the nonintegrated aluminum goods manufacturer stands in much the same relation to its integrated rival as does the nonintegrated copper goods manufacturer to the integrated producer from which it must purchase raw material. And since in the case at hand we are talking about a projected concern that would fabricate end-use items out of both aluminum and copper, it is immediately evident that the effect of these relationships is painfully accentuated.

There is, to begin with, the same financial advantage accruing to sheer bigness (though users of aluminum do not have to contend with sharp, sudden, and fundamentally unpredictable price movements in the same way that copper users do); in 1950 total assets of Aluminum Company of America and subsidiary companies amounted to $800,000,000. Integrated aluminum producers, just as their copper industry counterparts and for precisely the same reason, are much less concerned about the spread between the price of refined aluminum and the price of aluminum finished products. Integrated concerns in the aluminum field also exercise a tacit though subtle control over the price of the basic raw material used by their nonintegrated competitors—sufficiently tacit to be effective while at the same time sufficiently subtle to stay for the most part out of reach of the antitrust laws. And in aluminum as in copper the much larger number of small producers tend to find themselves at times pushing their output onto a weak market in order to secure the revenue needed to meet fixed costs, with the result that the spread between raw material and end-use prices is far more apt to narrow than to widen. (Note that between 1950 and 1960 this margin fell from 8.6 cents per pound to 4 cents.)

Actually, in only two ways does the structure of the aluminum industry differ significantly from that of the copper industry—from the standpoint of a nonintegrated plant contemplating a debut in the southeast in 1950. On the one hand, although aluminum even more than copper is a bulky product with a relatively low value per pound, for historical reasons basing-point pricing has never been an important factor in its marketing. Instead a "postage-stamp" system has come into use, with the result that a small plant in the southeast would to a considerable extent retain the transportation advantage of its location—while at the same time tending to be confined to its region by the high cost of transportation over long distances. On the other hand, because cheap electric power is an especially vital resource in the manufacture of aluminum, much of this product is turned out with the use of TVA power. This makes the basic raw material more readily accessible geographically to a Southern concern, and because transportation is such a major cost in the wire and cable industry this fact is highly important.

V.

The use of two basic raw materials in turning out two significantly different products is only one small dimension of the complexity of this industry. Let us, therefore, take a quick look at several other dimensions of this phenomenon in order more fully to appreciate the wide variety of headaches such a manufacturer might confidently anticipate.

In the first place, even these two products are put together into a finished product in a wide variety of ways. Thus there are products made for use indoors or outdoors, the type of coating used over the bare wires being quite different in these two cases. There are small double wires wrapped together each separately insulated, large 66-strand cables insulated only overall, cable for telephone use made up of many small wires each separately wrapped and stranded in such a way that no two are adjacent to one another on two successive turns, and even the very tiny wires often used inside various electrical mechanisms. Where aluminum is being used for long cable spans it is often stranded around one or more steel wires to give the aluminum additional strength. And copper wire made up to fit inside small spaces (as in an airplane subassembly) is often given a lacquer rather than a cloth or plastic covering.

The insulation field itself is a vastly complicated world to the uninitiated. Until a relatively few years ago this technology was quite simple, natural rubber being virtually the only insulating material used. Then fibre insulation came into wide use, and with the creation of the synthetic fibres the technological possibilities here became much greater. Still more recently plastic materials came into common use as insulators, and indeed the use of aluminum in electric cable was greatly aided by this development of insulating materials which would withstand high temperatures. And of course with the addition of plastics to an already long list of insulating materials this technology became exceedingly intricate.

Other aspects of the complexity of this industry can perhaps best be observed by following a piece of metal through the several processes required to manufacture a salable product. The most basic raw material of a wire mill is a product popularly known as "rods," copper or aluminum, an almost round piece of metal coiled into a unit containing up to several hundred feet. Rod, however, is typically not yet ready to be converted into wire, because the rod manufacturing process deposits an oxide coating which must first be removed. This is done by a process known as "pickling," or giving the metal an acid bath which will remove the scale deposited on its surface.

Nor is it a simple matter to get rid of this oxide scale in a fully satisfactory way, for the acids used in pickling may also attack the metal itself. The result of this may be tiny "burned out" areas so deep that even after further processing there will still remain undesirable blemishes. To prevent this certain "inhibiting agents" are mixed with the acid solution to bring the pickling action to a halt after all the scale has been removed and before damage has been done to the product. Quite obviously it is a neat problem to combine just the right mix of acid and inhibitors, and to schedule precisely the right duration for a particular bath, so that the raw material emerges both clean and whole.

After it has been cleaned the rod is taken to a wire-drawing machine. This consists of a succession of drawbar arrangements and dies so organized that the rod is pulled through what amounts to a succession of progressively smaller holes until, after it has been reduced to the desired size, it is wound onto an appropriately sized reel to be held for either shipment or further processing.

Here, too, the actual process is a good deal more complicated than it sounds when reduced to a couple of short sentences. For one thing each die must be enclosed in a housing which also contains a "lubricant" that reduces friction between the wire and the die thereby minimizing power needs, wear and tear on the die, and poor quality in the emerging product. Lubricant technology is itself a large subject, and it is important to make certain that the lubricant used will do the job assigned to it, that it is correctly mixed, is of the proper viscosity, and is at the right level in the housing.

The drawing mechanism is no less complex. Successive axle-type drawbars must rotate a little more rapidly than the one preceding because the length of product coming out of a die is greater than that going into it. Moreover, the speed factor here must be worked out to exact proportions; an axle revolving too slowly would soon begin to pile up product in its vicinity, while one moving too rapidly must shortly snap the wire in two —to say nothing of the advantages for product quality of maintaining just the right tension at all points.

Still another complication at the wire-drawing machine has to do with the fact that electric wire and cable products are typically sold in large rolls consisting of a single piece of unbroken wire. In order to be able to do this economically it is necessary to "butt-weld" lengths of rod together before the drawing process begins. Another machine is employed to do this job, usually operated by the same men who operate the adjacent drawing machine, a mechansim as nearly foolproof as modern science can make it. Nevertheless, the finished product at the point of this weld is often defective—and may even break and cause an expensive shutdown of the drawing machine.

Still another complication which must be dealt with is the fact that drawing a metal into wire has side consequences for the metal itself which must be kept within fairly narrow bounds. Specifically this process rearranges the "grain" of the material thus making it "harder"—and of course it follows that the more dies a given piece of metal passes through the greater is the resultant hardening. The reason this outcome of the manufacturing process must be limited is because on the one hand it makes the end product more difficult to work with at the point of use, and because on the other hand (especially in the case of copper) the end product is a better conductor of electricity if it is not so hard.

The remedy for this difficulty is quite simple in concept. Enough heat must be applied to the metal to restore to it some of the softness it has lost through processing. But actually doing this, effectively, is not nearly so simple. The "annealing" process must be so organized that all lengths of the metal, even those far inside an eight-inch deep coil, heat evenly in the interest of a uniform end product. Perhaps even more important the heat bath thus administered must penetrate evenly through the entire cross-section of the metal to its very center. And above all the annealing operation must be inserted into the overall process at just that point at which the annealed material, while being immediately workable on the machines, will not again become harder than desired before it is packaged for sale.

After the finished bare wire has been "packaged" on coils by the drawing machine, it must next be put with whatever other materials it is to be combined with in making the finished product being turned out. For some purposes, as, for example, common household wire, individual wires are wrapped (insulated) first and then combined into a single unit. For many kinds of products, however, bare wires are stranded together (to secure a larger carrying capacity while still having a cable which is flexible enough to be manageable) before being wrapped. And this process, stranding, utilizes another type of machine simple enough in concept but requiring considerable skill in actual setup (threading) and efficient operation.

From stranding a product goes to the insulation department. Here, depending upon its end-use, it is given whatever further properties it will need to have a long, trouble-free life. Heat resistance is, of course, one of the most basic of these requirements, because wire carrying electric current does get hot and is therefore a constant fire hazard. In addition, however, some types of products must be made to withstand the elements: heat, cold, moisture, soil acids, and so forth. And to mention all of these problems in a single short sentence is to gloss over lightly the fact that especially in the last dozen years advancing technology and the big consumers (to say nothing of such organizations as Underwriters Laboratory) have greatly tightened standards in the electric wire and cable industry, and also that installation conditions have come to demand an almost unbelievable variety of specifications for different products.

And to give just a little idea of the variety of processes used at this point, two of the most basic can be briefly mentioned. In one the wire passes between rows of spindles wound with ordinary cotton thread, and there may be as many as a hundred of these in operation simultaneously, each being wound around the moving wire in such a way that an identical pattern of wrapping is left on all parts of the wire—with the entire mechanism so articulated that if a single one of these threads snaps the whole works comes to a halt until an operator has mended this break. In the other the wire is carried through a "housing" apparatus so put together that a liquid (hot) plastic is forced evenly all around it and then cooled to a semisolid state before emerging.

All of which is to say that if at its core the wire-drawing business is a branch of the metals industry, at its edges it takes on some of the characteristics of the textile and plastics industries.

VI.

And perhaps one final factor should appropriately be emphasized—one having less to do with wire drawing in and of itself than the type of industry classification into which this activity most closely fits.

The fact is that metal-working operations of any kind are what is commonly referred to as "heavy" industry. This means that they utilize more capital per worker, turn out a "hard" (durable) finished product rather than a "soft" one, and are typically thought of as going along with a more advanced stage of industrialization than is associated with "light" industry such as textile manufacture. Because, in other words, this type of industry was in 1950 far outside the pattern of manufacturing which had thus far matured in the South, here was another reason for thinking twice before trying to make a profit out of wire drawing below the Mason-Dixon line. Who could be sure that textile workers could be made into metal workers—and only in huge metropolitan centers such as Atlanta and Birmingham was there anything that even remotely resembled what might be called a pool of skilled metal workers.

At best the mortality statistics on new businesses could hardly be encouraging to men toying with the idea of setting up a wire mill in the deep South. On an average 30 percent fail during their first year of operation, 20 percent fail in their second year, and so on until at the end of 10 years only 1 in 10 can be expected to be still operating. And what then of the dreams out of which the other 9 first evolved? If these were the odds against success in businesses of all kinds, including filling stations, how much greater would be the odds against success in a "heavy industry" in the South in 1950?

VII. THE KEY PEOPLE

If all of this makes it clear that the wire-drawing business is not one to be gone into casually—without a great deal of careful planning, a sizable amount of capital, a considerable store of know-how, and perhaps above all a quantity of dogged determination—it is now time to look at the men who dreamed these particular dreams back in 1947, 1948, and 1949. And let's look first at the man who had much of the money needed, and was reasonably confident that he could get hold of the rest.

Roy Richards almost exactly typifies the classic American success story. That is, he is an unusually dramatic example of the farm boy making good in a large way. And yet there is a certain ambiguity in thus classifying this vigorous entrepreneur from the deep South. Paradoxically, though most of Roy's formative years were lived on a small Georgia farm, the fact is that his father was emphatically not a farmer. Indeed, he was almost everything but.

The explanation for this paradox is quite simple. It was Mother Richards who was the farmer, and it is not difficult to get the impression that it was her patient management of the family farm which kept her family's finances on a more or less even keel while her husband strove to keep his head above water in the face of a series of economic reverses. Indeed, there are those who suggest that it was from his mother that Roy Richards developed many of the character traits which account for his own success. Moreover, a brief conversation with this quiet, keen, and self-effacing woman does nothing to challenge this interpretation.

But if Roy Richards favors his mother in some respects, just as clearly does his father show through in others. Thus just as his father was evidently determined not to settle down to a career on the farm, so too has Roy built his professional life out of nonfarming activities. In precisely the same way did both father and son evidently determine early in their careers that they did not want to spend their lives working for somebody else. And just as the elder Richards had engaged in a wide variety of activities, so too has the son resisted tying himself down to a single type of enterprise. Indeed, in a number of ways the father's business career has been strikingly mirrored in that of his son.

For example, the father had at one time and another been associated with sawmill operations and it was in this business that young Richards launched his own career as an independent, free-wheeling, entrepreneur. He bought a sizable tract of timber land in Campbell County, using primarily borrowed funds, and proceeded to saw it up into railroad ties. And it was evidently in significant part as a result of his father's influence that he abandoned this activity—as the parent had earlier done. As Roy himself tells this story, his father would give him detailed descriptions of the saw lands he had worked some years before until he (the son) decisively understood that the raw materials now left in the Carrollton area were only "the crumbs from the table." But evidently the depression also had something to do with Roy's decision to give up sawmilling, for he is also quoted as having said many times that he is now glad that economic adversity drove him out of the sawmill business.

And another case in point is the fact that the father was for some time associated with a public utility concern. Shortly before the turn of the century a group of eastern capitalists put up the money for an electric light plant in Newnan, Georgia—the first of its kind in the state—and employed the elder Richards to supervise its construction. Then, after it had been completed, Roy's father was retained as manager—until working seven nights a week, week in and week out (for the electricity industry was at that time essentially a darktime activity) threatened his health. Though Roy's work in the electric light and power field has differed markedly from that of his father, it is not wholly a coincidence that it was in the electric light and power construction business that Roy Richards first called decisive attention to himself as a young man who knew where he was going and was losing no time getting there.

There was early evidence that this tall, handsome youth was in some way precocious. A long-time friend and business associate reports that way back in his first year in high school Roy stood "head and shoulders" above most of his classmates—not, to be sure, because of any intensive understanding of material assigned, but because of the extremely wide variety of questions he could answer out of sheer experience and/or observation and reasoning. Another long-time friend, this one an educator and one of his high school teachers (in fact, the man who, according to tradition, "sent Roy Richards off to Georgia Tech") recalls that at 17 Roy was already an exceptional young man in the maturity of bearing he displayed; there was never a hint that he was in any way burdened by age-consciousness. (To which observation Roy himself might well retort: "Why should I? Ever since I was 10 years old I had been doing a man's work on the family farm.")

Because of the shaky foundation on which the family's finances then rested, Roy's education became a bit involved. There had been a bankruptcy in the family in the early 1920's, and the recovery from this disaster was not rapid. In fact, Roy on his own initiative interrupted high school education in order to do what an energetic and ambitious boy of 14 could do to ground his family financially a little more solidly.

Evidently, this move met with some success, for the following year saw Roy Richards returning to the halls of learning. But there was a difference. Instead of reentering the public school system he had left, he enrolled in the Martha Berry Highschool—an institution at which young men and women could "earn their keep" while they were furthering their education. Two things in particular stand out in connection with this experience. One was a contact with Henry Ford, the Berry school's primary philanthropist, which, though fleeting in duration, may well have made a considerable impact on the development of this lad whose career was already pointed so decisively in the direction of independent entrepreneurship. The other was the prompt recognition by his teachers and supervisors of an almost precocious mechanical ability; almost immediately Roy was put in charge of the Berry shops and in this way began to settle himself into the channel which would shortly carry him to Georgia Tech.

After a year at Berry, Roy returned to the public school system, enrolling in Carrollton A & M, a prep school which was soon to become West Georgia College. Here it was that the commitment to Georgia Tech became final. His educator friend, A & M's principal and West Georgia's first president, took an immediate interest in Roy and helped him resolve any doubts he may have had about whether or not he would go on to college. And four years later, in 1935, Roy Richards was an honor graduate of the Georgia Institute of Technology—becoming the proud possessor of a Bachelor of Science in Mechanical Engineering.

There was of course no question in Richards' mind whether or not to "go independent," even though the nation was still in the grip of the "Great Depression." The only question was, what business to "go independent" in? And of course it was only natural that one of the first possibilities explored was sawmilling. This was the occasion on which he borrowed money, bought a tract of timber land, and proceeded to turn trees into railroad ties.

But an activity so prosaic and so limited would hardly have occupied this fertile mind for long in any event, and he was therefore soon casting about for other worlds to explore. Nor was it long before he was beginning to get some definite ideas. The Rural Electrification Administration had recently been created by Congress, and one of its earliest projects in Georgia was in the vicinity of Carrollton. Why not secure the contract to supply this project (and perhaps later other R.E.A. projects as well) with the line poles it would need?

But this project, in the form in which it first presented itself to him, never saw the light of day. One reason, perhaps, was the fact that an R.E.A. engineer with whom he was at one point discussing his plans asked a few searching questions about why an honor engineering student would insult his training in this way. At the same time, however, it was surely that intense spirit of independence which had already become so characteristic of this man which made these questions strike so bright a spark. Why, indeed! Why had he taken several years of his life acquiring competence as an engineer if he were to spend his life making smaller pieces of wood out of larger ones? Why not raise these sights, and bargain with the R.E.A. about doing the entire building job?

He did, and with sufficient conviction that he was awarded this contract. Again using borrowed money he set to work—and so well satisfied the contractee that other contracts were forthcoming as well. And he was also able to get out of these jobs for himself enough of what a businessman goes into business for—money included—to make him want to expand his operations. Moreover, young though he was, and despite the fact that he was in a business which had been important in this country ever since the invention of the telegraph, he proved to be a most resourceful entrepreneur. Whereas before the accepted way of putting up a line of wire had been to first put up the poles and then to go back and string up the wire, Richards shortly worked out a division of labor for his crew that enabled it to complete the work on each pole almost before its hole had been refilled and tamped down. Small wonder this energetic and innovative young man was soon being given contracts by private utilities as well as government agencies. His reputation created a demand for the services of his firm in a number of countries in Central and South America. This concern put up 50,000 miles of electric wire line before this activity became a much less dominant item on the agenda of Richards and Associates.

Why did a man with this background and these talents begin to think seriously about going into the manufacture of electric wire and cable? Of course, one part of the answer to this query is the simple fact that, as a major user of electric wire and cable products, he knew these could be bought in the main only outside the South; at this time the only producer of these products in the entire Southeast was a small plant located in Chattanooga, Tennessee, and even there a contractor could not purchase anything like a full line of wire and cable products. Furthermore, Richards had an especially good picture of the demand for electric wire and cable in the South because he had recently begun a trucking operation, built around the wire mill in Chattanooga. Given a huge local (the Southeast) market for a product, the cost of which is to a significant extent the expense of transporting it, what could be more obvious than that here was an excellent opportunity for an aggressive entrepreneur who does not especially mind hard work and anxious moments?

But at least one other major consideration must have helped tip the scales at this point, for Roy Richards is the possessor of a regional pride which in 1948 and 1949 must have been almost fierce. And it is only necessary to hear him expound briefly on some of his pre-World War II experiences with northern businessmen to understand that this was certainly a factor.

Back in 1938, he will say with much feeling, virtually all northerners "looked down their noses" at businessmen from the South. Why," he will then recall, "it was often necessary to convince men with merchandise to sell that we knew how to use their product before they would make up a bill of sale." One specific incident especially well illustrates both the situation that existed and why Roy Richards developed so intense a reaction. On one occasion he sat with the salespeople of a large eastern concern. After telling them just enough about his plans to make clear the nature of the materials he was there to buy, he was all but swept off his feet by their insistence that what he planned to do could not be done that way—that others had tried to do this but had failed. "Gentlemen," he remembers saying, as the only way he could think of to end a worse than useless discussion, "I came here to buy goods, and I have the money to pay for them. It seems to me that the only thing you need to decide is whether or not you will fill a cash order for me."

And so it developed that a proud southerner began to think about one major way in which he could show the business North once and for all that "we in the South are not barefoot." An aggressive young businessman in Carrollton, Georgia, was given one more reason why it might be desirable to carve out in the Southeast a market for electric wire and cable produced in the Southeast.

VIII.

But Roy Richards well knew that he could not embark on the manufacture of these products single-handed. Also needed was someone who understood this business from the inside in a way that he, Richards, had not yet had an opportunity to acquire. Therefore he began to search for the kind of intimate know-how which would mean the difference between success and failure. And in a surprisingly short time he found exactly what (and perhaps even more than) he was looking for. By what almost in retrospect seems the sheerest coincidence that, the man with whom he was soon seriously discussing his dreams had himself been dreaming very much the same dreams on his own.

As soon as one begins to get acquainted with Roger Schoerner and Roy Richards it is plainly evident why they became attracted to one another. Both are endowed with a very liberal quantity of both nerve and vision. Just as clearly, however, there are basic differences. And the broad outline of the two careers prior to 1950 emphatically highlights perhaps the most fundamental of these. Every step in Roy Richards' career had clearly been moving him toward the role of financier and promoter. Roger Schoerner's work history, on the other hand, had just as clearly been marking him for the role of patient, careful, day-by-day administrator—and the man whose detailed understanding of ways and means, of alternatives and their consequences, of necessities and impossibilities, would provide a background without which viable top policy decisions could not be made.

Roger's father, too, was a small businessman. And he was doing fairly well, until the depression of the 1930's seriously crippled his operation. At that point the son, a young man in his teens who had typically been provided with everything his middle class friends had enjoyed, was compelled to assess the implications of this turn of events for his future.

No doubt it was in and as a direct result of the atmosphere of his early home life that young Schoerner acquired an early determination to be a businessman of some kind—and preferably a free agent rather than someone else's hired manager. He recalls even now that as a boy of not more than 8 or 9 he was somehow introduced to the problem of overhead cost allocation and that he used up a lot of immature energy trying to puzzle out just what this phenomenon was all about. And equally vivid to him now is the recollection that at least this early he began to picture himself as a top executive in a big concern, a daydream which in a few years was to become in his still youthful mind a confident anticipation.

Into a life thus pointed, a personality thus integrated, the father's fall from prosperity must have been a blow almost atomic in its repercussions. Interestingly enough, however, though this experience may have deflected his strategy, it apparently did not deter his purpose. If "college on a campus" were now out of the question (there were two older sisters, and it was early decided that their college needs would have to be given first priority), there were nevertheless other ways of achieving this same objective. Accordingly, Roger Schoerner was soon waiting tables at a Waldorf Restaurant while attending the Bentley School of Accounting and Finance in Boston. That, he now recalls, was the experience which more than any other taught him both the value of a dollar and the meaning of work.

Interestingly enough, Schoerner came close to taking an engineering course himself. And no doubt if he had, this case would never have been written. However, a very influential person in his life—the president of the home town bank, and also for a time Roger's Sunday school teacher—advised strongly against it. "Engineering," he would often say, "is too specialized. What we need in business today is administrators, men with a broad enough perspective to see all around a problem." And because in a number of subtle ways this advice was highly congenial with Roger's own dreams and plans, he decided against an engineering training.

After receiving a two-year diploma from the Bentley School, Schoerner was forced to make a crucial decision. To go on—or not to go on? There were no obstacles in the way, provided only that he were willing to endure the standard of living of a student for a couple more years. However, there was also education of a different sort to be achieved, learning on the job, and he must now make up his mind which kind would be most valuable.

As so often happens, though, this decision was in a sense taken out of his hands. A professor sent Schoerner, as well as some of the other top students at Bentley, to visit a number of industrial concerns in the Northeast. On a visit to an Anaconda subsidiary, the people there took an immediate interest in this young man whose steps were already so obviously headed in the direction of business executive. They offered him a job—and he took it. And this decision soon proved to be mutually beneficial. Schoerner found wire mill work both interesting and challenging, while his first bosses found in him an aptitude for their business and a willingness to work hard which they could well afford to reward with promotions and pay increases.

From 1939 on Schoerner's connection with Anaconda was continuous—except for a period during World War II. And postwar as well as prewar he continued to make his mark and to accentuate his climb. Thus it was that an Anaconda plant superintendent originally from the very center of "Yankeeland" one day found himself talking about a business "partnership" in Dixie with a man who was motivated in part by a sort of defiance against the attitude toward the South of many businessmen to the north.

But this phenomenon, as seen from where Roy Richards stood, is surely no more strange than when viewed from the standpoint of the "Yankee." Here was a man who, in almost every sense of the term, "had it made" in the world of big business. He had so established his competence in the eyes of superiors that they had rapidly pushed him from near the bottom of the Anaconda hierarchy to a responsible position, and there was no reason for supposing that his climb into the higher reaches of management was over. He was fully at home in the industrial environment in which he both worked and lived, and had in the past dozen years or so put down some deep social and community roots.

And what was he talking to this man Richards about exchanging all this for? For his plant superintendentship in a sizable plant operated by one of the biggest concerns in the business, he would substitute the vice-presidency of a new and (for a time, at least) struggling firm in which his new title would not spare him from doing some of everything needing to be done—from janitorial work on up. He would be trading his security of position for an independent entrepreneurship venture which would throw him into active competition with his former employer, a competition in which the integrated concern has many advantages over its independent rival.

The big city world to which he had become accustomed, and the roots he had tediously put down there, would have to give way to life in tiny Carrollton, Georgia—where a "Yankee" might feel keenly the shadow of the local "Horatio Alger" in which he would be compelled to live. Running a heavy industry firm in a region where thousands of workers have for generations been turning out durable goods would be replaced by an enterprise endeavor in a region almost totally unaccustomed to the type of production contemplated.

Why? Why would a sensible man consider such a change? With so much to lose, what were to be the compensating gains?

One thing to be kept in mind, of course, is the fact that independent entrepreneurship had always been his dream. But, and as one talks to Roger Schoerner this becomes more and more apparent, that objective was something more than a dream; behind it, and rooted deep in his personality make-up, is the kind of belief-structure necessary to implement such a dream.

Roger Schoerner had received inspiration from the Anaconda and Alcoa stories. The founding of these two concerns highlights American individualism at its most rugged best. He again and again refers to his youth experiences as "free enterprise inspired." Indeed, as he talks in this vein one almost gets the feeling that inspiration is an active, tangible force in human life, and that a "call" to the vocation of independent entrepreneurship is simply not to be denied. Nor does this exaggerate. There can hardly be a doubt in one's mind, after talking with Roger Schoerner a half dozen times, that to him the man "called" to manage a reputable and successful business concern is engaged in a work in some respects comparable to that done by a man "called" to care for a church congregation. He was completely serious when he said about this case shortly after the idea was first proposed:

> Perhaps a project like this will help inspire another cycle of private enterprises now so badly needed if this nation is to continue to grow and develop. Some 50 years of technology and the business organization to correspond is now coming to an end, and it will require a lot of vision and ingenuity to develop the new economic America that must be developed.

There are other concepts, too, which point quite definitively to the belief-structure in which the Schoerner dream was rooted. One of these is confidence, and the others cluster closely around it. "Someone in any organization has got to have the confidence," is an expression one is likely to hear more than once in a single conversation. To the case writer, but clearly for the benefit of a subordinate sitting at the same dinner table, he once said: "I certainly hope Bob has the motivation to want to be one of the top men around here." On another occasion this became, "Surely you have enough ego to admit that you are far above the average at your level of operation." Sometimes his train of thought seems to add up to the proposition that an enterprise can be made to go essentially because the people who put it together "are determined to make it go." One of his favorite stories is the one about the young man who had no idea he could jump a 9-foot fence until the day he was chased by an unfriendly bull, and the meaning of this story to him is clearly that we all need the stimulus of some such dangerous pursuer most of the time.

But it must not be supposed from all this that the Schoerner philosophy and inclinations had during the entire Anaconda period lain dormant, to be aroused into an intense free enterprise energy by the appearance in his life of Roy Richards. For the fact is that Roger Schoerner had not only decided on his own that it would be good business to establish a wire mill in the South, but he had even tried to sell his own company on the idea of getting in on the ground floor of such an endeavor.

Over a period of three years these efforts at persuasion had accomplished exactly nothing. Why? To a man less convinced (eager?) than Schoerner of the desirability of this step, Anaconda's failure to take the bait might reasonably have been interpreted as evidence of economic infeasibility. For example, he himself will tell you that "it could not be proved on paper that it would pay off." And then he will likely add: "In sizing up alternatives in our kind of economic system, it is not enough simply to project the past; in addition, it is necessary to think in terms of possible basic reorganizations of the industry one is working in." But to this man his superiors' refusal to listen to him demonstrated something very different. "In a huge operation like Anaconda," he explains, "no one had the incentive to take the risk of making such a recommendation." And this glimpse at a highly bureaucratized business concern through the eyes of Roger Schoerner tallies closely with another factor which evidently made an important contribution to his willingness to leave Anaconda. "Even when I was a plant superintendent," he recalls, "at least three people signed everything. If one of us had dropped dead, it wouldn't have created even a ripple of confusion. I found this very frustrating."

IX.

This, then, is in brief why the Yankee administrator was ready to talk business with the promoter from Dixie. But willingness to talk business is one thing; readiness to sign on the dotted line was quite another. First both of these men had to be reasonably certain that the other was the "right" person to go into this venture with, for each understood that there might well be no second chance. Roger Schoerner made this consideration especially explicit when he said "I couldn't have made this break with just anyone."

Moreover, Schoerner can readily document this proposition, for he had already turned down one opportunity to make much the same break. An Oklahoma businessman had offered him the chance to help integrate a distributorship backwards to a manufacturing plant. But several things about this move did not seem quite right. Oklahoma was not Roger

Schoerner's idea of the place in the South to set up a wire mill. Then too, this man's product line was limited almost exclusively to building wire, one of the most ruthlessly competitive lines in the entire business. And while he does not suggest that there was anything "wrong" with the man making the offer, it is nevertheless pretty clear that this promoter from the Southwest did not strike a responsive chord in Schoerner in the same way that Roy Richards did.

Ask Roger what made him think that Roy Richards was the man he could go into this thing with, and you will get a most interesting response. He will first outline a few of the basic facts about the Richards' success story—inferring that these data, after all, are fairly indicative in and of themselves. But then he will sort of raise his eyebrows, as though to emphasize that there was really a lot more to this matter than a few bare facts, as he says, "I really went into that pretty thoroughly." And the expression on his face together with the tone of his voice as he says this makes you understand that he did indeed go into it "pretty thoroughly."

What was Schoerner looking for as he undertook to determine whether or not Roy Richards was the man? Clearly the crucial issue was whether he had the requisite nerve and vision. And while Roger does not say this explicitly, it is evident that he wanted to be sure that Richards had the nerve and vision to match his own. When he had satisfied himself that there would be no difficulty on this score, he was ready to begin making detailed plans.

And now ask Roy Richards the same question, "What made you think Roger Schoerner would make a likely major partner in this undertaking?" Again you will get an interesting response. Schoerner's youth and vigor, his aggressiveness, and his intimate knowledge of wire mill operation—these are the first things that will be mentioned. Then Richards will begin to branch out in a number of other directions. "I knew the people he worked for, and what they thought of him." "I had visited him in the plant, and with the Schoerner family in their home." "He was willing to move South."

Was the possession of a nerve and vision to match his own a less important consideration with Richards than with Schoerner? This is quite possible. If so, does this mean that Schoerner had reservations about the adequacy of his own nerve and vision while his potential colleague did not? Assuredly not. What this suggests is rather that, once joined together in a major business venture, these two men would stand in a different relationship to that venture.

This possibility can be emphasized in two somewhat different ways. First, because Richards would control the money, Schoerner's nerve and vision could easily go up in smoke unless it were matched. On the other hand, precisely because it is most important that the nerve and vision available be where the money is, Richards' confidence in his own supply of these qualities could be decisive. And he himself came close at one point to making this quite explicit when he said, in another context, "If it hadn't been Schoerner, it would have been someone else. I was determined to do this thing."

But second, and equally important from where Roger Schoerner stood, the Richards method of operation made this decision even more a vital one. Already Roy was in a half dozen enterprises (he had, for example, just sold a chain of theatres), and there was no reason for anticipating that his interests would become less diverse. And in all of these endeavors the management pattern was much the same. The second man in charge was expected to be intimately familiar with all aspects of the operation involved, and basically to administer it—while Roy himself as president concentrated primarily on policy matters. Obviously, in the face of a program such as this, it was necessary for Roger Schoerner to make doubly sure about the calibre of the man with whom he was about to get involved· Not only must he be the type of man who can attend to policy questions on a half dozen fronts simultaneously without getting bogged down in a mass of detail, but the nerve and vision he brought to his work would have to be impressive indeed to remain more or less intact in the face of this six-way split.

X.

Both of the men were satisfied that they had found the right person to throw in with in setting out on what could only be described as a gamble even though it was also to both men a long-cherished dream. But there was one other major figure who had to be taken into account. That was Mrs. Roger Schoerner. Could she be happy enough in the little town of Carrollton, Georgia, so that her husband's full energies could be devoted to the tremendous task of building and successfully operating a wire mill in the South?

Elaine Schoerner's original home town was Chicago, and she had at this time been living in the New York area for a number of years. Could she move from Chicago and New York to Carrollton, a little town with only 12,000 inhabitants some 50 miles from Atlanta over roads which left much to be desired? And she, at the time the Richards-Schoerner plans were in the process of being finalized, was pregnant and unable to visit Carrollton to see whether or not she could be happy there. In fact, Carrollton was at that moment in the process of building its first modern hospital, and it was not certain whether or not it would yet be in operation when Mrs. Schoerner's baby came.

And to make this decision even more difficult, Elaine had during World War II done a certain amount of following her husband from one army camp to another *in the South*—and had had a miserable experience. To be sure, some of this misery could be attributed to war conditions generally, some more to the sheer rigors of living on a "temporary" basis, and still more to a distaste for life near a service "reservation." But the fact remains that Mrs. Schoerner had had these experiences, that they constituted her only first-hand experience with life in the South, and that this period of her life was still quite vivid in her mind.

And one other thing, too, had to be a pretty important factor in her thinking. A husband cannot gamble with his career without at the same time gambling with his wife's career as well. There was already a little Schoerner boy of 2½ running around the house. Soon there was to be brought into the world another little Schoerner—under what circumstances (if the move to Carrollton were made) no one could yet be sure. And perhaps this would not be the last. Where was the money coming from to do well by these children, to make a reasonable showing before the world in the career she had already so irrevocably embarked upon?

Interestingly enough, Mrs. Schoerner does not volunteer these financial considerations when asked how all of this looked to her at the time—though possibly she might on longer acquaintance. When pressed she will concede that she experienced a sensation much like standing on a narrow ledge in the face of an immense cliff. Then she will confess to thoughts such as, "Why should we give all this up after advancing so rapidly with Anaconda?" But then she recalls that these same thoughts helped her to believe her husband could also do what he set out to do in the South. And she herself volunteers the sentiment she clearly means to have accepted as the decisive factor involved when she says (in a tone of voice suggesting that this is really all there is to be said on the subject); "I wanted Roger to do what he wanted to do, and he seemed enthusiastic."

XI. THE PLACE

Roger Schoerner did not lack for advice from his associates when reports of his impending departure from Anaconda began to be noised about. And it ran almost the entire gamut of possibilities. There were those who "accentuated the negative," pointing out to him again and again how great were the odds against him, and therefore how foolish he would be to make this change. Another, though a much smaller, group congratulated him and wished him well, and in the comments from these associates were several hints of a willingness to move South with him. But perhaps the thoughts Schoerner appreciated most were those of his immediate superior. This man, too, had once had a yen to go into business for himself and had done so. However, his career was precisely the reverse of the plans Roger Schoerner was now making. Driven to the wall in his own operation, the boss had by now reconciled himself to finishing up his life of work within the protective framework of the big concern. "Don't eat up your profits," he recommended. "That's what happened to me. I put everything I made into our standard of living, and when harder times came, there was nothing to cushion the shock."

To be sure, this advice did not prompt any particular second thoughts. It was already understood between Richards and Schoerner that they would play their cards pretty close to their chests while working toward an ambitious 10-year program of expansion. The comments he received which perhaps did bother Roger a little were those having to do with the location of the proposed new plant. Why Carrollton, Georgia? Not only was it a tiny place with virtually no background of factory operation outside the textile industry, but it was nowhere near a navigable waterway. And everyone knew that an operation in which transportation costs are as important as in wire and cable manufacture must have immediate access to water transportation. Though the Tennessee River is not the greatest navigable waterway in the country, at least the founders of the first wire mill in the South had had the forethought to select a site, Chattanooga, at which boats of some size could come and go.

Why Carrollton, indeed? It would hardly have done to expound to Anaconda associates on the most important (as well, in one sense, as the most obvious) reason for deciding on Carrollton. Most assuredly they would not have been impressed. But after all Carrollton was Roy Richards' home town.

However, this way of putting the matter surely makes it far too simple. America is a vast economy in which young men by the thousands are making for themselves new home towns every day. Certainly, a man with the capacities of Roy Richards could have made his way quite well in a much more challenging environment. Why was it that in 1950 he was still content to center his activities in the little community of his youth?

Almost out of a clear blue sky Roy's educator friend in Carrollton will let fall some remarks bearing on this question. All during those important career-forming years immediately before and during college, the fact that Roy Richards would spend his working life as an independent entrepreneur was taken for granted between these two. "And," Dr. Ingram will proudly add, "I repeatedly urged him to make Carrollton his scene of operations—on the grounds that Carrollton needs the creative talent of such people more acutely than Atlanta, New York, Cleveland, or St. Louis. Whatever you decide to do, I would say to him, do it here."

These urgings by a man who was probably quite a significant influence in Roy Richards' life were in one sense unnecessary. There is a powerful temptation to make good in one's own home town. Moreover, Roy Richards was already in 1950 becoming widely recognized as one of the most active and devoted civic leaders in the Carrollton area. Elaine Schoerner could take much comfort in his personal promise that the new Carrollton hospital would be ready for her when she was ready for it, provided of course she didn't "jump the gun," because he perhaps more than any other leader in Carrollton had assumed the responsibility for getting this much needed facility built. No doubt a man of this caliber and character would get a great deal of satisfaction out of contributing to the development of a community which he could with much reason feel had contributed much to his own development. Nor is it to be supposed that this man made this decision to carve out a career in Carrollton without a clear understanding of what was involved. As he himself put it, in answer to a direct question, "It has never been my purpose to live and work where I could make the most money, but where I could find the greatest happiness."

Sentimentality? Well, in a way. Perhaps the more neutral term "noneconomic" would do as well. But if Roy Richards had reason to be lured in part by noneconomic considerations into establishing a wire mill in Carrollton, Georgia, this was not the case with Roger Schoerner. How did this proposed location look to him? What answer could he give to the taunts of his associates "back East" which would still permit them to think of him as a businessman with his feet on the ground?

Two things, primarily, could be emphasized, showing that Schoerner evidently did not have serious reservations about the Carrollton location. First, "a wire mill can have customers on only one side of a port. By contrast, Carrollton is the almost exact center of the largest circle you can draw that is entirely within the southeastern part of the United States." If the Southeast were to be the market, surely this was an argument with considerable economic validity.

Besides, in the second place, the water transportation argument assumes that a small, independent manufacturer must rely essentially on purchased transport. But why must this be accepted as a condition of entry? Suppose the new mill in Carrollton were to integrate its operations from the outset to the extent of being a major carrier of its own goods! Wasn't it at least conceivable that sources of raw materials could be developed in the vicinity of customers, and goods sold in the vicinity of available raw materials, with sufficient regularity so that a trucking operation on the side would at least compensate for the absence of water transport facilities?

And one other important consideration at least helped to rationalize this step which had already all but been decided upon. After all is said and done there is not a lot of difference between one firm's wire and another's. Therefore, a major focus of competition in this business is service. Why wouldn't a wire mill running its own trucking establishment achieve gains in customer good will which would still further help to make the availability of water transportation less critical? Of course no one could then have known for sure that answer to this question, but the people down at Richards and Associates were pretty certain they did.

No doubt the Schoerner detractors in New York merely hooted at this idea, but the fact was that the Richards operation in Carrollton had already had a good bit of experience hauling wire and cable products for the relatively new firm in Chattanooga, and was therefore in a better position to have an informed judgment on this matter than were men who had never before heard of such goings on. To be sure, Roger Schoerner himself was compelled in a sense to take Roy Richards' word for these possibilities. But if his partner-to-be did not necessarily live his life to maximize his monetary rewards, it certainly did not follow that he would either willingly or carelessly slip into a no-profit activity on the business side of his life.

In short, alternative locations were not intensively investigated. Chattanooga on the Tennessee River was of course out, because this was an operation Roy Richards wanted to succeed—perhaps primarily because of his pride in his region vis-à-vis those "Yankee" businessmen. (And note that neither of these "ambassadors for free enterprise" gave serious thought to any other location at which cheap TVA power could be purchased.) Atlanta was recognized as a possibility, being greatly superior to Carrollton in labor availability, but it did not seem to either man that this advantage justified shifting their planning from Carrollton to another area in which water transportation was not accessible. Savannah, an attractive port city, was talked about, but Savannah is not (even on its land side) the center of a particularly promising market for finished wire and cable products. Mobile came out better on this score, but at the moment this decision was made Alabama's incumbent Governor, "Barefoot Jim" Folsom was simply obnoxious to young progressive businessmen. And besides, both Savannah and Mobile have a hot, humid climate which Schoerner especially felt would not bring out anything like the best in factory workers.

Why Carrollton? Interestingly enough, this bare statement of a few facts may really do this little town in West Georgia a grave injustice. There is a sense in which it was ripe in 1950 for a development such as the advent of a vigorous, nontextile manufacturing concern.

Carrollton is not as intensely "deep South" as its location in Georgia would suggest. Georgia was the last of the 13 original colonies to be founded, and that here as elsewhere in the New World settlement proceeded westward from the Atlantic Ocean. Carroll County, Georgia, one of the tier of Georgia counties bordering Alabama, was not established until 1827. Moreover, at the time the issues between the sections erupted into a bitter Civil War, there were few slaveholders in the county, and many people were too busy clearing land to be much concerned about a war which seemed to be none of their affair. The folklore of the area contains little material growing out of that bloody conflict—material such as officers contributed, or deeds of heroism by boys dedicated to the cause of the South. By contrast, on the other hand, in World War II Carroll

County provided more volunteers to the armed services in proportion to enlistment-age population than any other county in the entire nation.

This same spirit of aloofness manifested itself after the Civil War. When a reconstruction legislature began to enact punitive legislation, the citizens of Carroll County openly defied it. In response to one tax measure, for example, they held their own referendum, repudiated the law, and announced that in Carroll County the tax would not be collected. And it wasn't. A little later this defiance was carried to the point of outright secession. The citizens in the area voted to declare themselves "The Free State of Carroll." They had, it was insisted, all the resources they needed to be prosperous and happy, and therefore they could easily get along without the rest of the state.

It would perhaps only be expected that out of an attitude of independence so deeply rooted there would arise a spirit of free enterprise. Before the Civil War, Carroll County could boast a textile mill. And it was in an adjoining county that Roy Richards' father supervised the construction of the first electric light plant in Georgia. Other industrial activities, including textile mill operations, followed. Furthermore, to a much greater extent than in most Georgia communities of this same size, the people of the area actively carried forward the kind of planning and developing which would make their community attractive to capital investors—and we have it from Roger Schoerner that this was a significant factor in his own calculations.

To be sure, the textile industry which developed in the South after the Civil War was not all that might have been desired, at least by today's standards. But therein lies another story which further explains why Carrollton was especially ready for the plant Roy Richards and Roger Schoerner were in a mood to establish.

To an extent the people of Carrollton probably did not appreciate at the time, there grew up around them what was for all practical purposes a one-company town. And of course this is not such a bad thing, after all, as long as everything goes along smoothly. But everything did not go along smoothly. During the 1930's the "one company" got in trouble, and all during the 1940's it was pretty generally understood that it was "only a matter of time." Thus even before the end finally came the progressive-minded element in town had resolved that this must not be allowed to happen again—that the industry of the city must be developed along much more diversified lines. Within the framework of this kind of thinking, the possible location in Carrollton of a firm engaged in a "heavy industry" operation was almost the answer to a prayer.

And looking at these considerations from another point of view, here is one more reason why two men decided to team together to establish a South-based, independent wire mill, in Roy Richards' home town, Carrollton, Georgia, a place wholly lacking in one of the resources heretofore considered a must in this industry—water transportation.

XII. THE TIME

The decision to "do it" had now been made. So too had the decision of where it was to be done. There remained the question of when. Should it be now, now being 1949, or should it be later? When would be the "right" time?

Like Patrick Henry they had "no way of judging of the future but by the past." And looking back at the immediately preceding years, they were not at all encouraged that finding a "right" time would be at all easy.

Both men had been straining at the leash since 1946. But the end of the war had marked the beginning of a period of inflation during which independent wire mills had had an exceedingly difficult time securing a large enough supply of rod to meet their needs. Then, no sooner had this pressure eased than the first postwar recession had settled down over the economy. Indeed, the index of industrial production was well below the postwar high when Roy Richards and Roger Schoerner were compelled to decide whether or not they would plan to make their leap immediately.

In other words, perhaps just the right time would never come. Of course, they had no way of knowing this at the time, but the decision to embark now would run them squarely into the confusions, regulations, price adjustments, and shortages of the Korean conflict. And this was precisely what they concluded. Accordingly, plans were laid to begin building a plant during the last quarter of 1949, and to begin drawing wire during the first quarter of 1950.

APPENDIX

THE THINKING OF TOP MANAGEMENT AS OF 1949

I. Manufacture of limited range of popular sizes of wire, solid and stranded, used by the REA, utilities, and communities in the South. Initial operations will include products made from copper, aluminum, and steel on the following basic machines:

1 to 7 die wire drawing machine
1 to 9 die wire drawing machine
2 to 7 wire hi-speed stranders

A. It will be the policy of the company to produce quality material at a competitive price. Since this will be the first wire company in the deep South, the general initial sales efforts will be made stressing a product of Southern manufacture to be sold in the South. In line with this general sales program all of the labor materials and services used by the new company will be of Southern origin wherever possible. Until Southern supplies can be developed, any existing facilities will have to be used.

B. The long range aim of the company will be to produce a complete line of products that can be turned out on a production basis. Specialty items will not be handled by the manufacturing division. If at a later date a change in policy is deemed wise in order to carry a complete line of products, both in production and specialty items, the specialty items will be purchased from producers better set up to handle them and will be handled on a "jobber" basis either by the wire company or by a separate sales organization to be formed at a later date.

1. Ultimate line of products will include the following:

Bare copper wire—all tempers
Bare aluminum wire—all tempers
ACSR aluminum conductors
Copperweld conductors
Stranded aluminum conductors
Range of WP Products—URS
Wire supply to other Southern insulators

C. Wherever the purchase volume of a material or supply is large enough to warrant it the company will take over the production of these items for its own use.

II. These general objectives will be attained with the following:

A. Financial.*

1. Total capital $200,000, ½ to be owner capital and ½ to be bank loans.
2. Of the owner capital, Roy Richards to contribute a controlling share.
3. Two-thirds of the remaining owner capital to be supplied by corporate insiders, ½ of this amount by Schoerner.
4. A small block of stock to be made available to key Southern industrialists.

B. Knowledge, capabilities, and experience.

This new venture will draw on the following:

1. Proven executive ability of Roy Richards to handle sales, purchasing and engineering, good-will, and general relations.
2. R. Schoerner, with operational experience at the superintendent level, to handle manufacturing and general administration.
3. Personnel and resources of existing Richards enterprises.
4. Local industries for electrical, mechanical, tooling, and other miscellaneous skills.

C. Location of manufacturing facilities and sales efforts.

The new company has the following advantages of geographical location:

1. Nearly flat plant site (check drainage and soundness and availability of water for quality and temperature).
2. Railroad siding can be made available from main line.
3. City water supply available.
4. Outside city limits in industrial zoning.
5. Other successful enterprises in location.
6. Good main highway facilities.
7. Reasonable value of land—$8000 for 10½ acres.
8. Just off high voltage transmission lines.
9. Local gas mains available.
10. Check fire and police protection.
11. Good potential labor market—labor will have to be educated and trained in production methods.

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* With the exception of Richards' investment the capital contribution of individuals was either already invested in trucking facilities, or was to be paid-in in the future.

12. No competition to east or south with manufacturing facilities. Nearest competitive plant at Chattanooga, Tenn. Many wholesale storage areas from large Northern producers.
13. No unions in control of operations in locality.
14. Check employee transportation facilities.
15. Housing will have to be developed with growth.
16. Tax and political history exceptionally good.

III. General comments on customer demands, attitudes and competitive facilities.

A. It is felt that the immediate demands of customers greatly exceeds the manufacturing facilities now being made available and that their attitude toward this new Southern enterprise will be such that present output will be chopped off easily.

B. In the long range programs of a complete line of production products it will be necessary to instill efficiency and quality in the sales program to insure a proportional share of available volume.

C. The sales facilities, skills, profits and financial resources of competitors now active in the region to be covered by Southwire Company are tremendous, but there is room for a company with manufacturing as well as sales facilities in the South. To assist in maintaining a stronger position the company will attempt to align itself with one or more of the larger producers of copper, aluminum, and steel.

Lick Skillet Feed Lots, Inc.[*]

Eleven years ago, Barney Holland made his first purchase of ranch land, a 2,000 acre tract bordering on the Red River in southeastern Oklahoma. Holland had observed the rapid movement of people off the farms to cities during and after World War II. Farm land prices in this part of Oklahoma were depressed, and the land seemed to be selling at bargain prices. Up to April 1, 1961, an additional 5,500 acres had been acquired in the vicinity of the original purchase, but prices had been rising at a fairly rapid rate since the first purchase. Previous owners of the land had carried on a combination of row crop cultivation (chiefly cotton and feed grains), and cattle raising.

Large-Scale Ranching and Feeding Plan

Holland had plans to acquire enough land, as nearly as possible contiguous, to engage in large-scale ranching and feeding of cattle. The fertile alluvial river bottom lands selected had a capability of producing enormous quantities of good quality hay and feed grains. This geographical area was selected for a number of reasons. Holland, who had been reared on a ranch in north-central Texas, remembered hearing farmers and ranchers complain about (1) lack of rainfall (water), (2) lack of lime in the soil, (3) disadvantageous marketing arrangements, with cost of uncertainties and lack of information falling largely on the farmers and ranchers, (4) high transportation costs to market, and (5) shortage of capital to properly equip and operate a farm or ranch.

A geologist and graduate of Princeton University, Holland applied some principles of geopolitics in selecting for his purchases the area where the combination of factors seemed optimal. Approximately 200 miles from either of two central livestock markets, the area had excellent transportation connections to either market center. Early in 1961, a sales contract with a large meat packer had been negotiated, assuring a continuing market outlet. Annual rainfall (50–60 inches) was more than ample in the area. One factor still lacking was adequate finance capital.

Analysis by Certified Public Accountant

Holland had used personal funds derived from other enterprises to purchase ranch lands and equipment. In a methodical search for the best plan or combination of operations to utilize the land and develop its resources, he employed a certified public accountant to aid in the analysis of various possibilities. The CPA had submitted three reports on his studies and findings, as follows:

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[*] Prepared by Henry Key, Texas Christian University.

CPA Report No. 1 (September 22, 1959)

Mr. Barney Holland
2809 North Main Street
Fort Worth, Texas

Dear Mr. Holland:

This is the first report of the progress made thus far on the ranching assignment which you gave to us about this time last month. The assignment is to explore the various production possibilities of your ranch lands in the southeastern section of Oklahoma, giving immediate and prior attention to your cattle operations.

Our first approach was to review your cattle operations for the past several years, noting that from the beginning you have maintained a cow-calf herd[1] ranging from an initial 80-cow to a present 205-cow herd. Your practice has been to sell each year's calf crop and keep your heifers for breeding stock, while using the normal culling procedure with your cows. Approximately one and a half years ago you started a small steer herd which has grown to a present 500-herd count. It became apparent soon that you were amassing a large investment in cattle. With knowledge of your present investment in land and equipment and a growing investment in cattle, our immediate concern was directed to the total investment and the manner in which it was financed.

We prepared a schedule of the debt as of September 1, 1959, in connection with your ranch land, equipment and cattle showing the monthly requirements for retirement during the next year. It was obvious that your debt requirements on land alone would approximate the proceeds from the sale of your calf crop. This left no funds with which to finance your ranching expenses. Our next step was to examine the actual ranch expenses for the year ended December 31, 1958, and for the eight months ended August 31, 1959, as a basis for estimating and forecasting for the next twelve month period. By using your present herd of cows and steers and being fortified with your carefully planned estimates and evaluations of markets, price trends, growth or gain capacities, feed costs, and operating expenses, we compiled a cash budget for the year 1959–60 starting with September.

Several assumptions were made in the preparation of the cash budget which reflects a cash deficit of $37,208 for the next year. If our assumptions turn out fairly close you will have met all operating expenses, debt and interest payments, and made the necessary capital expenditures. It should be noted that the entire debt on your steer herd is assumed to be returned in arriving at this cash deficit which is another way of saying that you can generate enough income from your cow and steer herds this next year to meet all your cash requirements, including a reduction in the amount owed on the steers. Based upon the assumptions used in the preparation of this cash budget three suggestions were made to eliminate the cash deficit anticipated by the budget.

As we continued in our discussions with you, it became desirable to compare estimated income from cow-calf and steer operations. This was undertaken on a *Present* and *Proposed* basis. Our objective in this analysis was to determine

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[1] A cow-calf ranching operation involves breeding cows annually, keeping the calves six to eight months, and selling off the male animals together with culled heifers and cows. Young heifers are retained for future breeding purposes. Grazing off grasslands with some supplemental feeding is the usual practice.

Lick Skillet Ranch and Feed Lots
Ranch Cash Budget
for Year Ended August 31, 1960

Cash receipts			
Sales of calves and cull cows—150 head @ $125 each		$18,750	
Sales of steers—130 head @ $170 each		22,100	
Sale of steers—1,500 head @ $170 each	$255,000		
Less: Cost of 1,500 steers @ $122 each	183,000	72,000	
			$112,850
Cash disbursements			
Operating expenses		$66,400	
Capital expenditures		2,400	
Debt retirement		81,258	
Total Cash Disbursements			150,058
Net cash deficit for year			$ 37,208

which type of operation was more desirable and profitable. From the analysis we observed that your present 250 cow-calf operation on the Hilltop Ranch will not pay its way much less make the payments on your other ranches. Even if the herd is increased to 500 head the return (including debt retirement) on total investment is only 6½%. The greatest return rests with the 750-steer[2] operation which is 16% compared to 12% on the 500-steer operation. An additional investment of $32,500 is estimated to run a 750-steer operation over a 500-steer operation. This represents cattle costs on which interest is computed in arriving at excess income over expenditures.

Lick Skillet Ranch and Feed Lots
Analysis of Present and Proposed Ranch Operations
1959–60

	Present		*Proposed*	
	250 Cow-Calf Ranch	*500 Steer Ranch*	*500 Cow-Calf Ranch*	*750 Steer Ranch*
Sales revenue	$22,000	$72,000	$44,000	$108,000
Operating costs	19,557	43,597	29,189	64,042
Net revenue	$ 2,443	$28,403	$14,811	$ 43,958
Less: Interest on herd	...	3,250	2,500	4,875
Net return	2,443	25,153	12,311	39,083
Debt retirement	5,000	3,250	5,000	3,250
Excess or (deficit)	$(2,557)	$21,903	$ 7,311	$ 35,833

Using data from the September, 1959, issue of *The Farmer,* we prepared a schedule of "Computation and Comparison of Profits on 1,000 Head of Common Steers Run on Lick Skillet Ranch & Feed Lots." The favorable result of this computation serves as a good check point against the results of our *Present* and *Proposed* analysis of the 500 and 750 head steer herds respectively. It becomes apparent by comparison of the two schedules, that the estimates of total feed, pasture and operating costs of $56.46 per head are low compared to a similar cost of $66.79 per head on the 500-head *Present* operations. This can be readily explained by a careful analysis of Estimated Other Costs, which are applied on an arbitrary basis. Yet this analysis does point up a key figure for future reference which is the "Net Selling Price Needed to Recover Costs" or "Breakeven Point." Further development of this figure is planned in the near future.

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[2] A stocker-steer is a desexed male animal raised on range grass with some supplemental feeding, and ranging in weight from 500 to 800 pounds. It is not usually of slaughter quality until fattened on a feed lot.

Being faced with the dilemma of having present annual fixed debt requirements on your land purchases, in excess of the net revenue being produced therefrom, it becomes necessary to take some action to generate more net revenue or reduce fixed requirements either by refinancing or sale. In view of the fact that you have spent many years acquiring a good working knowledge of your ranch capacity and have sought expert counsel in planning your herd and, further, based upon our own estimates of profit, it is our suggestion that you continue in your present program for the next twelve months using whatever financing arrangements are necessary to meet your requirements. Your costs of operation per head will decrease as the size of your herd increases and greater profits are a natural result of experience and efficiency.

Our next step will be to plan a chart of accounts and an accounting reporting service to be used by your accounting department to begin to compile accounting and statistical data necessary to give a current and accurate appraisal of the trend in your actual cattle ranching operations. We propose to continue compilations of data upon which wise and prudent decisions in your cattle operations may be based.

Respectfully submitted,
CAPERS & BRANTLEY
Certified Public Accountants

CPA Report No. 2 (August 31, 1960)

. . . .

Your present program of buying 500 pound stocker steers, running them on pasture from November through August with supplemental feeding, and dry lot finish feeding through October, upgrades the animal to a 1,000 pound choice slaughter grade. The feeding costs may be expressed in the following manner:

	Pounds Weight	*Cost*	*Gain per Day (pounds)*	*Cost per Day*	*Cost per Pound Gain*
Steer purchased, November 1	500	$100.00			
Graze and feed, November through March	150	30.00	1.00	20.0¢	20.0¢
Graze and feed, April through August	262	20.76	1.75	13.8¢	7.9¢
Feed lot finish, September through October	138	28.84	2.75	57.7¢	20.9¢
Finished steer	1,050	$179.60	1.57	22.7¢	14.5¢

Total cost per steer will be approximately:

	Total	*Per Pound Gain*
Steer purchased	$100.00	
Feeds purchased	79.60)	14.5¢
Interest on land	2.00)	
Land management fee	2.00)	
Labor	5.25)	
Miscellaneous* (including hay)	28.77)	6.9¢
	$217.62	

* Among miscellaneous costs, other than hay produced on the ranch, are the death loss at 3 percent, noncash fixed costs, and out-of-pocket cash costs for veterinary and medical, minerals, salt, and so on.

Based upon the foregoing costs, your profit per steer sold at various prices would be:

Sales Prices (pound)	*Profit per Head*
20 cents	$(7.62) Loss
21 cents	2.88
22 cents	13.38
23 cents	23.88
24 cents	34.38
25 cents	44.88
26 cents	55.38

The profit potential of this program is predicated upon buying in the traditionally low price months of October and November. The average price for stocker steers in October during the past seven years has been 21.53¢ and the price has not been lower than 20¢ since 1946.

We conclude that a price range between slaughter steers at 26.04¢ and stockers at 21.53¢, a 4.51¢ margin, is not unreasonable. However, since the average price over the last five years is 24.72¢, the profit per head would be $41.94, which produces a very favorable return on your investment in land. Even if we use the average purchase price over the past 14 years, your cost of 22.86¢ and selling price of 25.26¢ would return a profit of $33.31 per head per year.

The following table will show your position in a high rainfall area, in comparison with other areas of medium and low rainfall:

	Rainfall Areas		
	Low, 20 Inches or Less	*Medium, 20–30 Inches*	*High, over 50 Inches*
Cost per head, per day:			
Land 5 percent; management 5 percent	$ 0.19	$ 0.22	$ 0.02
Labor	0.02	0.02	0.02
Feed	0.11	0.10	0.23
Interest	0.02	0.02	0.02
Miscellaneous	0.05	0.05	0.05
Total	$ 0.39	$ 0.41	$ 0.34
Days on grass and feed	270	270	270
Pounds gain per head	75	270	532
Acres per head	20	10	0.4
Cost to gain	$105.30	$110.70	$ 91.80
Cost/pound gain	1.40	0.41	0.17
Land cost per acre	25.00	60.00	100.00
Land cost per animal unit	500.00	600.00	40.00

It appears that the optimum steer herd for you to run would be limited only by the capacity of the land you possess. However, since your operation costs have been determined from your experience with the herd you have been running, to increase your herd too rapidly may cause a loss of control of operation costs. Moreover, since it is not always profitable to sell at the seasons when prices are at their peak, it becomes necessary to plan programs of production and marketing to determine the greatest net returns. From long range studies of beef cattle prices, stocker steers could be purchased from June through December at lowest prices. Marketing of choice slaughter steers could be done almost any month without any great degree of seasonal price fluctuations. These facts seem to indicate that a constant monthly buying and selling program should be adopted rather than buying in bunches and selling in bunches. Such a program permits a great deal of latitude in deciding when to market individual steers. In addition, this program would tend to minimize the element of risk inherent in lot purchases and sales brought about by short range price problems, such as over-production and drouth. The average income per animal would be less, but, the variation in income in a year would also be less, which could be very important in some years.

Respectfully submitted,
Capers & Brantley,
Certified Public Accountants

Reviewing these reports in the spring of 1961, Holland ran over the various possible uses to which the land might be put. First, cultivation of the land in various crops had not offered adequate return on the value of the land. In addition, this use required high manpower cost on a seasonal basis. Supply of experienced supervisory personnel and labor at just the right time was uncertain. Acreage controls on principal cash crops put limitations on possible revenue from this source.

The next plan that had been considered was cow-calf ranching. This method of land utilization showed more promise than crop production alone, but potential return on investment did not seem to be particularly promising. The CPA report had pointed up the fact that the former scale of operations with cow-calf production was not generating enough revenue to cover out-of-pocket costs and debt amortization requirements.

A third plan involving purchase of stocker steers and grazing the natural grasses, with hay production from the land to meet winter-time needs, was presently under experimental trial. This plan required some feeding of high concentrate protein feeds (cotton seed meal or soy bean meal, with fortifying additives). It offered better returns than plans one or two but still was not particularly attractive.

If dry lot feeding[3] of cattle were to be engaged in, how much land should be assigned to this enterprise? Should some lands be sold to raise capital to put into a feed lot enterprise? What method of financing should he use for large-scale feeding of cattle on dry lot? Surveys indicated that very few publicly listed corporations have engaged in cattle raising and feeding. Dry lot feeding has expanded rapidly in the Southwest after World War II, a few operations (for example, Lewter Feed Lots of Lubbock, Texas) having been well publicized.

One thing holding back agriculture generally, Holland believed, was the disinclination of the average farmer or rancher to utilize fully the technology available to him. He tends to try to adapt himself to nature. If he plans to increase output, he usually thinks in terms of more acres rather than more intensive utilization of the land.

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[3] Dry lot feeding involves keeping the animals confined in a small area, with only minimum movement possible, while feeding of high concentrates of grain, cotton seed or soy bean meal, and hay goes on continuously for 90 to 120 days. 200 to 250 head constitute a single lot or feeding group.

At this juncture, Holland addressed the following letter to the CPA:

Fort Worth, Texas
May 30, 1961

Messrs. Capers & Brantley
Certified Public Accountants
Fort Worth, Texas

Dear Mr. Brantley:

I have been reviewing results of the past year's cow-calf operations, and the steer grazing-feeding experiment, which you recommended in your Report of August 31, 1960. Neither of these enterprises has shown any appreciable improvement over past experience or forecasted results. For instance, the recent sale of the calf crop at a gross of approximately $17,500 is only 10% on the investment of about $175,000 used for this activity. We have utilized the best and most advanced practices and the animals were of high quality, averaging 410 pounds each and selling for 28 cents per pound. Forty of these Angus heifers placed in the Reserve Champion class at a recent Show-Sale in Fort Worth. We have averaged better than 85% on the calf crop, a highly respectable record.

In spite of the good performance record and above average price, the gross return hardly covers interest (at 6%) on the investment and a 5% amortization pay-out on the principal. It is therefore clear that current out-of-pocket operating costs have not been recovered. As to the stocker steer grazing-feeding experiment which we have undertaken in the past year, results have been only slightly more encouraging.

Now that we have experimentally verified results predicted in your Report of September 22, 1959, and the second Report dated August 31, 1960, I believe that it would be advisable to investigate a fourth alternative use of the ranch lands. I refer to a steer dry lot feeding operation such as the one being conducted by Lewter at Lubbock, Texas. It is not clear whether the lands can be utilized efficiently and effectively in the production of feed grains and hay, or whether these should be purchased. Some commercial lots do engage in production of feeds and silage. Delta Pine and Land Company of Scott, Mississippi, and Deseret Farms, Inc., of Leslie, Georgia, both follow this practice. Some of the lots in West Texas also grow feeds and silage. If we are not to follow this practice, it may be advisable for me to sell any excess lands not required for the feed lot operations, should we find sufficient justification for going into this phase of the livestock business. If your studies should provide evidence of an adequate return from feed lot operations, as with the previous plans we will go into this phase on an experimental and limited basis to accumulate data and experience to guide us before expanding into large scale production.

I am convinced by observation and evidence in my possession that the average farmer or rancher enjoys scarcely no economic return on his managerial effort and his investment. The sole proprietorship approach generally used is fraught with peril, especially in regard to the impact of inheritance taxes upon death of the owner. Heavy long term borrowing usually must be resorted to by the surviving heirs, to raise cash to pay the assessed tax liability. Repaying the liability, with interest, will continually deplete working capital, with consequent short term borrowing and interest cost for current operations, and will require a lifetime of hard effort to clear the property of debt drag. Deaths in rapid succession in a family can be disastrous in these circumstances.

In your studies, I would like for you to keep these propositions in mind:

1. In scheduling operating costs, allow management the same rate of remuneration as would be required in any commercial or industrial firm of comparable scope and responsibility.

2. Compute the commonly used financial ratios, such as net income to sales, rate of return on total investment, turn-overs, etc. These ratios must be at least as favorable as a typical commercial or industrial firm to justify the plan you may be willing to recommend.

3. The plan you develop must be good enough to support a public sale of corporate stock on terms as advantageous as any commercial or industrial enterprise. If this cannot be done, then I want you to be as frank and impartial in your recommendations as though you were advising the prospective investors.

4. The plan your study should consider is a year-round continuous operation. It should be a plan for a "meat factory" utilizing the most modern technology available. Substitution of machine power for human labor in agriculture, although it has gone a long way, has not taken place to the extent that has occurred in industrial plants. Tax laws favor the enterprise that makes use of labor saving machinery and processes. The cattle industry appears to be headed toward the same revolutionary change as has occurred in the chicken industry in recent years. Better ways to add a pound of meat with fewer pounds of feeds must be and are sure to be developed.

5. As a final step, I will consider the sale of my lands and reinvestment of the proceeds in ways more appropriate to my situation if we cannot reasonably justify, on an economic basis, the investment I have made to date.

I shall be happy to confer with you from time to time as your study progresses.

Yours very truly,
Barney Holland
Lick Skillet Ranch and Feed Lots

Pursuant to this letter, Brantley undertook an intensive study of feed lot operations, and on July 23, 1961, addressed the following report to Holland:

CPA Report No. 3 (July 23, 1961)

Mr. Barney Holland
2809 North Main Street
Fort Worth, Texas

Dear Mr. Holland:

When we began our research program in August, 1959, you were conducting a typical cow-calf type ranch grazing program. Our first cost study released to you on September 22, 1959, pointed up the deficiency in your grazing program to reach a break-even point much less generate enough income to meet debt retirement requirements on the total land investment. At this time you changed to a combination cow-calf and steer grazing program. We developed a cash budget for one year under this program using operating cost based upon your actual expenses of prior periods. Although you were able to develop this program to a point of normal returns expected by the average rancher, this was not meeting our budget of producing a 5% return for management plus a 5% return on investment in land and facilities. Our reasoning was that you should be allowed a 10% return on the fair market value of your investment for owning and managing your operation.

From operating costs and statistics compiled by you while operating your steer grazing-feeding program, we completed a special report dated August 30, 1960, in which we showed an analysis of ranch costs, projection of profit potential and returns on your land investment. By using these studies and your operating experience you were able to launch your present steer feedlot operation which will produce much greater returns on land and facilities than we had projected as is shown in our report.

You have transformed a typical ranch grazing operation into a well integrated manufacturing plant with new profit potentials heretofore not conceived as possible by most ranchers. Moreover, the vast areas of development of your ranch lands should challenge the best of management. Because of the magnitude of the areas to be developed and the need for adequate capital, we are of the opinion that you should no longer undertake to finance these developments from your personal funds. Since such great demands are already made on your personal time and abilities from your other enterprises, we feel that you should consider establishing a continuity of management of the resources on your ranch lands for the benefits of your family and your estate. We advise that you bring into fruition the many years of your own personal time, energy, and wealth in this venture through the use of venture capital which will not only provide the needed financing but also will attract capable management. Actually, you will be trading a portion of your equity for expansion and development capital and management assistance.

Having reached this conclusion through our intimate knowledge of your personal financial affairs, we have prepared a proposal for the development of your ranch lands and facilities which we recommend you discuss with your legal counsel and financial advisors. We request that any departures or variations from this proposal be discussed with us.

Respectfully submitted,
Capers & Brantley,
Certified Public Accountants

PROPOSAL FOR DEVELOPMENT OF LICK SKILLET FEED LOTS, INC.

Proposed Capital Structure

A corporation, Lick Skillet Feed Lots, Inc., will be chartered with 200,000 shares of $1 par common stock authorized. The corporation will acquire the assets and assume the liabilities of Barney Holland, Lick Skillet Ranch and Feed Lots, by issuing 100,000 shares of its $1 par stock to Barney Holland. The balance of the authorized shares will be issued to subscribers at $9 per share, of which $1 par value will be credited to Capital Stock and the balance to Capital in Excess of Par Value.

The proceeds under this proposal will be used to purchase steers for feedlot operations, to make debt retirement and to provide working capital, as follows:

Steer and feed inventory—100 head per week for 4 months	$302,050
Debt retirement—short-term debt and long-term debt maturing in 1 year	200,000
Working capital increase	72,950
Total	$575,000

Additional proceeds from sale of capital stock will be used to supply cattle for new feedlots in an expansion program. Pro-forma statements presented herein are based upon annual sales of 5,000 head of steers.

Feedlot Operation

This feedlot operation is entirely new in its concept and offers for the first time a program of buying, feeding and selling steers wherein the stockholder may know what his purchased costs are, what his actual feeding costs are, and finally, what his selling prices are, independently of the feedlot operator. The stockholder may compare the costs of steer acquisitions by merely reading the daily published prices. Feeding costs are easily discernible from predetermined costs of formulas. The stockholder will be able to examine sales prices based upon a national market. For the first time, a stockholder, under this proposal, will have internal audit controls over buying and selling which completely removes the element of inherent risk found in the usual feedlot contracts.

Feedlot operations can be classified into one of two usual types. One is the small 20 to 30 head type where the operator owns the steers, raises his own feed and sells on the open market. A second is the large operator who buys his feed and feeds cattle on a contract basis allowing the owner to sell on the open market. Lick Skillet Feed Lots, Inc., will combine the element of ownership of its land, equipment and cattle with its capacity to produce its own hay which constitutes a substantial portion of total feed costs. With its contract to supply slaughter steers to a packer on a weekly basis the further inherent risks in marketing are either removed or minimized.

Your sales contract to deliver 100 finished steers weekly at an average price published in the *National Provisioner Daily Market Service* will completely eliminate the costs which would be incurred in handling cattle in the usual manner through the commission agent. Not only are the costs of the stock yards such as yardage, commission, insurance, dues and feed completely eliminated, but the loss in weight and injuries due to extra handling of the cattle is avoided. The seller will not become the victim of price haggling and grade and weight guessing.

Cattle raisers producing less than $10,000 sales annually operating on a grazing program are expected to gradually disappear. The trend in cattle raising for beef consumption is toward the feedlot operation. Ability to produce your own hay requirements will yield a considerable saving on freight charges which most operators are now paying. There are no other feedlots operating in your area at this time. In addition, the supply of locally raised steers which you can purchase for your program is plentiful in your area. Freight costs to transport your animals to market will be much less than average due to the shorter distance from your ranch and feedlots to the market.

Feedlot Profit Potential

Projected profit potential at various levels of capacity follows:

	Number of Head		
	2,500	*10,000*	*20,000*
Sales price	$618,000	$2,472,000	$4,944,000
Cost	540,625	2,162,500	4,325,000
Profit	$ 77,375	$ 309,500	$ 619,000
Investment—Cattle and feed	$315,000	$1,260,000	$2,520,000
Inventory requirement (head)	1,666	6,666	13,332
Return on investment in cattle and feed:			
Before taxes	24.6%	24.6%	24.6%
After taxes	13.5%	12.2%	12.0%
Percent profit on sales:			
Before taxes	12.5%	12.5%	12.5%
After taxes	6.9%	6.2%	6.1%

Profit per head before taxes (Federal income) is approximately $30, of which approximately one-third may be attributed to savings of around $11 per head on cost of hay. The returns are not only comparable and competitive with other feedlot operations but also exceed those of many manufacturing enterprises.

The Lick Skillet Ranch and Feed Lots has become a vertically integrated manufacturing plant. Choice fed steers are its finished product. A large portion of the raw material is harvested in abundance from the ranch lands. The conversion factor is the feed mill. The graded finished product is then shipped via company owned transportation equipment to an established market.

Other Development Possibilities

The 7,500 acres of ranch lands contain about 5,000 acres of rich alluvial soil subject to cultivation. At $11 per head marketed each year, a maximum return of $550,000 from hay produced on the land can be assumed, representing a return of 55% gross on the land valued at $200 per acre. The remaining 2,500 acres are subject to development of known limestone and gravel deposits. The location of the Campbell Soup Company plant in the area should push the price of tillable lands to $300 per acre in a short period of time. All tillable acreage is subject to irrigation. Pecan trees abound on the lands, some of which are grafted to papershell varieties. Pecan culture of the best market varieties would blend well with the hay production requirements of the feedlot operation. Up to $1,320,000 revenue from pecan harvest could be developed. Camping facilities, hunting and fishing, and other recreational activities are potential sources of revenue of considerable magnitude. Grain storage facilities could supplement and dovetail with the feedlot business, as well as yielding revenue from storage for others. Agriculture still offers a tax haven for investors in the upper income brackets that is worth careful investigation.

Management

The corporation will look to its board of directors for its overall management. Each member of the board will be carefully selected to be in charge of a given area of development with benefit of the counsel of the entire board.

Barney Holland will be the director in charge of the feedlot operations. He has expended fifteen years of time and energy and personal wealth to acquire, develop, experiment and prove the desirability of exploiting the ranch lands and facilities. His faith in the feasibility of operating the feedlots at a profit is evidenced not only by his years of sustained efforts but also by his willingness and desire to transfer his entire equity into the corporate structure in exchange for stock only, with the sole purpose of continued operations.

Holland, age 41, is president, director, and stockholder of a major wholesale distributing company which was founded by his father over 25 years ago. He also owns and directs the activities of two or three corporate businesses closely related to the distributorship, and is a director of a bank in a city of 25,000.

Cash Flow

During the first year of projected operations beginning August 1, 1961, cash flow is shown by the following source and application statement:

Sources of cash:		
Sale of capital stock	$ 900,000	
Net receipts from sale of 5,000 steers	154,750	
Net receipts from sale of calves and pecans	26,000	
Total	1,080,750	
Add: Noncash charges (depreciation)	30,000	$1,110,750
Application of cash:		
Steer and feed inventory	302,050	
Payments on notes	200,000	502,050
Cash balance July 31, 1962		$ 608,700

Pro Forma Financial Statements

Lick Skillet Feed Lots, Inc.
Pro Forma Balance Sheet
August 1, 1961

Assets		
Cash		$ 900,000
Land and ranch improvements including mineral deposits		463,000
Cow and calf herd		57,000
Steer inventory (400 head)		80,000
Total Assets		$1,500,000
Liabilities and Capital		
Liabilities:		
Notes and accounts payable		500,000
Capital:		
Common stock, 200,000 shares, $1 par	$ 200,000	
Capital in excess of par value	800,000	1,000,000
Total Liabilities and Capital		$1,500,000

RANCH PERSONNEL

Holland spent a great deal of time in the management of the ranch properties, and had made the major decisions. Buddy Bullock, age about 35, lived on the ranch with his family and was in immediate charge of day-to-day affairs. A native of the area, he had acquired a good practical knowledge of cattle, although he had not been responsible for large-scale feedlot operations such as might develop. His formal education did not

Lick Skillet Feed Lots, Inc.
Pro Forma Statement of Income and Expenses
Year ending July 31, 1962

Income:		
Cattle sales:		
5,000 head steers	$1,236,000	
250 calves	22,000	
Pecan sales	4,000	$1,262,000
Costs:		
Cattle, 5,000 head @ $100 each	$ 500,000	
Feed	445,000	
Management fee	20,000	
Labor	26,250	
Out-of-pocket cash costs, including transportation	45,000	
Noncash fixed costs	30,000	
Death losses	15,000	1,081,250
Net Income from Cattle before Federal Income Tax		$ 180,750

Lick Skillet Feed Lots, Inc.
Pro Forma Balance Sheet
July 31, 1962

(After giving effect to proposed capitalization and one year's proposed operations)

Assets

Cash		$ 608,700
Land and ranch improvements including mineral deposits	$463,000	
Cow and calf herd	57,000	
Steer and feed inventory	382,050	
Total	$902,050	
Less: Depreciation	30,000	872,050
Total Assets		$1,480,750

Liabilities and Capital

Liabilities:		
Notes and accounts payable	$300,000	
Federal income tax payable	88,490	$ 388,490
Capital:		
Common stock, 200,000 shares, $1 par	200,000	
Capital in excess of par value	800,000	
Retained earnings	92,260	1,092,260
Total Liabilities and Capital		$1,480,750

extend beyond high school. Assisting Bullock on a full-time basis, another man and his family lived on the ranch. Other laborers were hired in the vicinity as needed at the prevailing rate of 75 cents per hour for common labor.

Bullock seemed to take great pride in showing a new feed mixing mill and explaining its operation to the certified public accountant and a visitor to the ranch. He remarked that a doctor from Houston had under construction a new feed lot a few miles away that was very compact in arrangement. He expressed the opinion that there was some risk in this arrangement from fire, tornadoes, storms and the like. Lick Skillet Feed

Lick Skillet Feed Lots, Inc.

10-Year Cash Flow Summary

	1952	*1953*	*1954*	*1955*	*1956*	*1957*	*1958*	*1959*	*1960*	*1961**
Receipts:										
Sale of sheep and cattle	$ 464	$ 2,094	$ 3,217	$ 7,520	$ 8,809	$10,223	$ 9,569	$24,694	$44,466	$ 157
Pasture rental	638	...	...	...	189	...	...	...	...	...
Sale of crops, produce	239	...	596	...	868	...	...	...	...	...
Sale of pecans	...	...	...	...	...	521	...	3,500	1,653	...
Gain on sale of breeding stock	...	...	...	357	...	1,055	...	...	...	...
Sale of timber	77	...	...	...	...	2,338	...	1,937	...	...
Miscellaneous receipts	...	...	...	...	...	262	647	...	...	...
Total Receipts	1,418	2,094	3,813	7,877	9,866	14,399	10,216	30,131	46,119	157
Expenditures:										
Salaries and wages	1,756	500	947	2,324	3,946	5,860	6,573	8,603	7,363	4,200
Feed purchased	89	137	1,428	1,536	1,634	2,553	4,946	6,372	25,539	6,163
Supplies purchased	697	854	358	112	502	1,602	1,267	1,348	1,681	675
Freight and hauling	280	275	455	675	134	910	542	1,579	160	80
Livestock veterinarian, medical	7	12	551	602	58	895	107	108	139	317
Machine hire and labor	343	1,751	3,489	2,339	3,131	823	1,107	3,946	347	840
Planting and plowing	2,278	1,333	1,642	517	1,454	1,265	...	...	150	...
Gas and oil supplies	...	137	65	82	598	1,296	1,133	1,216	1,345	1,292
Utilities	20	53	75	377	574	895	1,058	1,075	1,526	2,621
Repairs and maintenance	154	788	2,507	889	600	2,718	2,796	1,578	753	794
Memberships, travel, promotion	96	77	79	151	379	676	599	685	681	292
Insurance, interest, taxes	2,917	3,401	3,972	3,868	3,064	5,153	6,557	13,281	13,780	7,015
Professional, legal	201	250	80	91	287	97	541	67	...	...
Miscellaneous	250	2,146	...	314	2,043	1,321	...	...	...	2,300
Total Expenditures	9,088	11,714	15,648	13,877	18,404	26,064	27,226	39,858	53,464	26,589
Excess of Expenditures over receipts	$7,670	$ 9,620	$11,835	$ 6,000	$ 8,538	$11,665	$17,010	$ 9,727	$ 7,345	$26,432

*Through August 17, 1961.

Lots, Inc., buildings, mixing mill and feed lots were spread out and were not subject to this hazard to the extent that the other lot would be.

At the Barnes Place, recently purchased by Holland, electricians were installing wiring to the grain storage building. Purebred Black Angus cows and calves were observed grazing in a nearby pasture. A truck load of hay was delivered to the storage barn, about 200 feet from the grain shed. Bullock explained that the new attachment to the mower crinkled and crushed the coarse stems of the hay plants, causing them to dry much faster than they would otherwise do. It was possible to mow early in the day and bale late the same day, avoiding the risk of thunder-storms that might damage the cut hay. Cattle eat the crushed stems but leave uncrushed stems in the troughs. The protein content of

EXHIBIT 1*

AVERAGE ANNUAL STEER PRICES ADJUSTED FOR SEASONAL VARIATIONS AT APRIL AND OCTOBER OKLAHOMA CITY MARKET

			Seasonal Index		
			Good Stockers		*Slaughters April and*
Year	*Stockers 500–800#*	*Slaughters 900–1100#*	*April—105*	*October—94*	*October—99*
1940	$ 8.29	$ 9.40			
1941	9.81	10.43			
1942	11.29	12.35			
1943	12.15	13.57			
1944	11.30	13.87			
1945	12.22	14.74			
1946	14.46	16.21			
1947	18.59	...			
1948	23.90	...			
1949	21.26	24.20	$ 22.32	$ 19.98	$ 23.96
1950	26.25	28.42	27.56	24.68	28.14
1951	32.39	35.04	34.01	30.45	34.69
1952	27.26	31.99	28.62	25.62	31.67
1953	17.25	22.57	18.11	16.22	22.34
1954	16.67	22.72	18.55	16.61	22.49
1955	18.28	22.06	19.19	17.18	19.00
Total	282.37	277.57	168.36	150.74	182.29
Average	$ 17.65	$ 19.83	$ 24.05	$ 21.53	$ 26.04
Supplemental Prices:					
1956	$ 18.39	$ 20.96	$ 19.31	$ 17.29	$ 20.75
1957	21.69	22.88	22.77	20.39	22.65
1958	29.84	26.89	31.33	28.05	26.62
1959	31.35	27.15	32.92	29.47	26.88
1960 (First half)	27.43	25.73	28.80	25.78	25.47
Average	$ 25.74	$ 24.72	$ 27.02	$ 24.20	$ 24.47

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* Compiled from Bulletin No. B-486, February, 1957, Oklahoma State University, Division of Agriculture, Experiment Station. Supplemental prices furnished by letter from James S. Plaxico, Professor of Agriculture Economics, Oklahoma State University, to Leonard H. Brantley, CPA.

this hay mixture had tested as high as 18 percent compared with the usual 5–10 percent.

"Mr. Holland is sure a fine man to work for," concluded Bullock as Brantley and the visitor were departing.

EXHIBIT 2

Average Quantities of Feed Used, Rate of Gain and Feed Cost per Pound of Gain, by Specified Feeding Periods and Grain Prices*

Feeding Period (Days)	*Feed Requirements per Day by Specified Periods (Pounds)* Grain	Cottonseed Meal	Silage	*Gain Per Day*†	*Cost per Pound of Gain,‡ with Varying Grain Sorghum Prices (Cents)* $1.75§	$2.00	$2.25
0–28	3.64	1.97	21.32	2.29	7.55	8.19	8.84
29–56	6.85	1.65	16.96	2.02	10.37	10.60	12.52
57–84	10.67	1.86	14.32	2.54	10.84	12.04	13.25
85–112	12.68	2.07	10.10	2.27	13.62	15.14	16.68
113–150	14.56	2.20	9.05	2.55	13.41	14.92	16.44
151–181	14.00	2.27	6.39	1.98	16.78	18.68	20.53
Average = 180	10.59	2.00	13.33	2.27	12.15	13.35	14.78

* Adapted from Texas Agricultural Experimental Stations Progress Reports 1089, 1190, and 1407 by J. M. Jones *et al.*

† Feedlot weights, 450-pound initial weight.

‡ Sixty dollars per ton cottonseed meal assumed with each grain sorghum price.

§ Dollars per hundredweight for grain sorghum.

EXHIBIT 3

Results of 15 Public Cattle Feeding Demonstrations Conducted in 1960–61

Demonstration	*Number Cattle*	*Average Starting Weight*	*Average Finishing Weight*	*Average Daily Gain*	*Average Cost per 100 Pounds Gain*	*Average Pounds of Feed per Pound of Gain*
1. Levelland, Texas	25	509	826	2.73	$18.76	9.06
2. Kremlin, Oklahoma	26	633	978.9	2.68	16.11	6.77
3. Weston, Missouri	51	829	1031	2.27	14.08	6.28
4. Oakley, Kansas	19	838.42	1270.78	3.09	15.30	7.05
5. Holyoke, Colorado	68	510	849	2.85	11.33	7.01
6. Newcastle, Utah	13	492	802	2.80	17.70	5.90
7. Oshkosh, Nebraska	21	444	900	2.85	13.60	6.68
8. Jerome, Idaho	45	763	1040.8	3.23	19.32	6.53
9. Sheridan, Wyoming	20	685	1024	3.03	16.28	6.50
10. Yuma, Colorado	116	671	981	2.77	14.86	7.16
11. Ft. Morgan, Colorado	76	648	922	2.42	15.09	7.00
12. Akron, Colorado	22	751	1056	2.85	14.74	7.08
13. Harrisonville, Missouri	17	684	1054	2.66	18.77	8.29
14. Ashland, Kansas	25	829	1164	2.92	16.40	8.14
15. Oberlin, Kansas	8	724	1194	3.59	12.94	5.70
Average for 15 demonstrations	37	667.36	1006.16	2.85	$15.86	7.09

Source: *The Cattleman*, May, 1961, p. 39.

APPENDIX

"Feedlot Expansion Predicted for State," article by James E. Vance in *Fort Worth Star Telegram,* March 22, 1961:

New emphasis on feeding cattle in Texas feedlots marked the final session Wednesday of the Texas and Southwestern Cattle Raisers convention in Fort Worth. Cattlemen packed into the Hotel Texas ballroom heard a panel tell of cattle feed and climatic conditions and potential market that make Texas a "natural" for feedlot production of beef.

. . . .

The cattlemen heard R. B. Tootell, governor of the Farm Credit Administration, Washington, predict that ranchers and farmers will borrow more money for future operations. He reasoned that units will continue to expand, and for operators to make the changes fast they'll do it on borrowed capital, rather than if savings alone were used.

Tootell added that the supply of money to finance sound operations will be adequate from lending sources. He said that of the $25 billion now on operating loan to ranchers and farmers only 2 per cent is from the federal government.

. . . .

During the cattle feeding panel a Brawley, Cal., feeder, E. D. Rutherford, predicted the time will come when all beef except hamburger will be graded, and all cattle will be finished in a feedlot to afford the same supply of meat every day of the year. Rutherford also predicted cattle feeding will double within 10 years and possibly increase fourfold in Texas.

Durward W. Lewter, a Lubbock (Texas) feedlot operator, said it costs five times as much to freight feed to cattle as it does cattle to feed. "Freight cost is one thing which can ruin a cattle feeder. We have the grain and cottonseed products at home, so we don't have to ship cattle to where there is feed," Lewter explained. "We have the greatest potential anywhere, but the success lies in 'honest' feeding. Feed cattle where they'll give a packer buyer a 60% dressing[4] or more and he'll come back for more cattle." Lewter also said West Texas feeders have climatic conditions in their favor for operating feedlots.

Another panel member, Lloyd Bergsma, said the feeding industry has been retarded by lack of development of established outlets for Texas-fed cattle. Bergsma, livestock marketing specialist for the Texas Agricultural Extension Service, added that a survey shows if only one-third of Texas' 9 million ton feed crop in 1960 had been utilized as cattle feed it would have been enough to supply all the 2,500,000 feeder cattle available in Texas. He said Texas feedlot operation has increased, but the need is to establish a quality reputation for Texas-fed beef and the potential will be unlimited.

"All That Farm Capital . . . How do You Get It?" article by Henry Simons in *Farm and Ranch,* June, 1961:

We'll probably see even bigger increases in the financing of farmers by dealers and processors in the future, particularly since they are willing to finance farmers with relatively low equity.

This expansion has long since come about in broiler business, and for years has been standard procedure with canning companies in financing the farmer's production where he is growing under contract.

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[4] Dressing out 60 percent means that a 1,000 pound steer will dress out 600 pounds of meat carcass, after removal of hide, offal, and waste.

Banks are going to be called on for increasingly larger amounts of production money, plus more intermediate-type loans (those two to five year loans needed when a farmer goes into a livestock or dairy enterprise, or expands an existing one, to make it more efficient.)

. . . .

Even though bankers hate to think of it, we may come to a situation of "perpetual debt," much like corporations have, where the loan is never fully paid off in the farmer's lifetime. And if banks don't do the job, new forms of government credit may come into the picture to do the job for them.

The "perpetual debt" idea is one that is likely to kick up a lot of dust. Many people tend to confuse issues when the corporate structures come into play, and start taking off on "huge farms" as opposed to so-called family farms. Still the pressure for larger chunks of capital will help speed this development.

. . . .

What do bankers look for as collateral? One of the first things is real estate —the farm itself, if it is not already mortgaged. If the farmer has a strong financial statement, they may lend to him unsecured, or supported by a chattel mortgage on the crop or livestock, the production money he is seeking. (One California cotton farmer told us that he borrows from the Bank of America—the world's largest—at the "prime rate" and puts up no collateral at all for a six-figure seasonal line of credit.)

The average return in the U.S. to farmers on their invested capital was 3.2% last year—less than you could get by investing in government bonds. A 6% interest on investment (as figured in "How Much Investment to Make $5,000 Profit?" May, *Farm and Ranch*) is certainly more realistic than the 3.2% farmers actually got. It would make the lending proposal more attractive from the lender's standpoint if he were assured the farmer was making this kind of return from his investment. But a Ford Motor Company official was heard to say recently that they prefer to let banks or finance companies handle the financing of their cars for 6% interest, because Ford aims for 10 to 12% in manufacturing.

. . . .

Risks in agriculture, compared with other industries, are high. However, you have to qualify this as to the type of agriculture you're talking about. A farmer growing a crop with government price supports (like cotton or tobacco) and using an irrigation system plus a good insect and disease control program, wouldn't be considered a big risk. Neither would a farmer, who borrows to feed out cattle, if he has his own feed supply. (Cattle increase in value as fed.)

. . . .

Excerpt from "Your Cow and Calf Business," Bulletin 956 of the Agricultural Extension Service, Texas Agricultural and Mechanical College:

Farmers and ranchmen, like many businessmen, frequently fail to keep and study sufficient records to *Know* the business they are operating. Cattlemen should keep enough records to determine the profit and loss and production efficiency of the enterprise and then they should investigate the probable costs and returns of new practices that would correct major problems. Finally, they should use those practices that will make their cow and calf business more profitable.

. . . .

Often cattle producers think in terms of more land and more cattle as a means of making more money when the present operation actually could be managed more efficiently and result in 50 to 100 per cent increase in profit. An analysis of production in terms of pounds of calf produced per cow and the pounds of calf required to pay the annual costs will point out that small increases in production per cow can make large increases in profit.

. . . .

Changing Market Channels. The importance of the central auction market, traditional for handling livestock sales, has been declining since World War II. The Fort Worth, Texas, stock yards have been reduced to one-third the area used before 1950. Numerous local auction markets have sprung up over the country; however, the central markets still establish the price basis on which trading takes place. Direct sales contracts with packers is a growing practice, with deliveries on a continuing weekly basis. The seller is believed to benefit because (1) he eliminates a considerable amount of marketing costs and haggling over weight, quality, and price; and (2) he is not at the mercy of the auction market (where he is under some compulsion to sell, after having incurred transportation costs.) The buyer benefits by (1) eliminating guessing as to what the supply situation will be; and (2) being able to specify what weights and grades of animals will be delivered.

Southern Foods Corporation*

In 1950, the Southern Foods Corporation, a fresh fruit and vegetable wholesale firm, located in Quincy in the heart of Dixie was concerned about its future. The company, originating as a fresh fruit and vegetable house in 1934, had added beer, distilled spirits, and wine to its line, along with adding a few grocery items from time to time. In 1950 the firm was serving an area of about 100 miles radius from Quincy. By 1950, the firm was handling about 700 different grocery items and the contribution of this activity, as shown in Exhibit 1, appeared to be encouraging.

EXHIBIT 1

SALES AND NUMBER OF CUSTOMERS, BY DEPARTMENTS OF SOUTHERN FOODS CORPORATION FOR 1949

Department	*Number of Customers*	*Sales*
Distilled spirits and wine	375	$1,529,605
Beer	713	1,206,034
Fresh fruits and vegetables	900	3,173,245
Groceries	900	600,000
Total sales		$6,508,884

Although grocery items had been added more as a service to some of the retail stores rather than with the expectation that this would develop into a major business activity, the Southern Foods people felt that handling groceries had proven to be profitable.

The original location of the Southern Foods Corporation was in an older building in the heart of the downtown shopping area. As its business expanded, it acquired adjacent property to be used as warehouse space. Prior to 1950, the firm had acquired all of the property in one block facing on Lee Street, doing such remodeling as was possible to meet the demands of its expanding business. This location was not suitable for receiving and shipping goods by heavy trucks in that it placed restriction on this activity, particularly during the day when normal downtown traffic virtually stopped incoming and outgoing shipments. The plant likewise was not suited to the more modern methods that were becoming essential to economical and efficient handling of goods.

When the firm was first organized in Quincy by Ben Adams, it was called Adams' Fresh Fruits and Vegetables. Ben Adams was compelled to quit school and go to work full time before he finished high school. His first job was in a grocery store. Later he took a job as a salesman for a wholesale grocery firm. He was a hard worker and was conservative in his spending habits. He selected Quincy, a city of about 25,000 people and about 150 miles from his present home, as a good location. Mr. Adams was 40 when he organized his own business in 1934. In 1938 with his business expanding he wished to bring his two sons, John and Albert, and his son-in-law, Fred Metz, into the firm. For these and other business reasons, he incorporated the firm, selecting the name Southern Foods Corporation. Shortly after this incorporation, Albert was fatally injured while on a hunting trip.

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* Prepared by J. Leslie Bayless, Louisiana Polytechnic Institute.

In the newly formed corporation, Ben Adams served as chairman of the board and president, with his son John acting as treasurer and office manager, and Fred acting as general warehouse manager. Ben Adams supervised all buying and selling of goods and continued to give strong leadership to the firm.

In September, 1940, Ben Adams had hired Tommy Jones to become a grocery salesman in the city of Quincy. Tommy had started out as assistant manager of a local grocery store. He was promoted to manager of a new store and served in this position for about two years before resigning to join Southern Foods. A good student in Quincy High School and College where he majored in business administration, he seemed to have the necessary personality, drive, and knowledge to become an excellent addition to the Southern Foods firm. Tommy's employment with Southern Foods was interrupted for three years while he served in the Navy during World War II. During his military service he completed officers' training and was assigned to Special Services. Upon his return from service, he was assigned to the accounting department. After Tommy had served about two years as an accountant, Ben Adams decided to bring him into the administration end of the business as general manager. This decision was based, in part, on the fact that Ben's health was failing, but more specifically on other circumstances. Fred Metz just didn't seem to take to the business in the manner Ben had hoped that he would. Fred wished to retain his affiliation with Southern Foods yet he had some outside interests that seemed to prevent him from devoting the necessary time and energy to accomplish the ultimate goals Ben had envisioned for him in the firm. John Adams preferred to be relieved of the responsibility of general manager. Ben Adams called a meeting of the board of directors to explain his plan for this change. He pointed out his desire to retain his son John as his assistant with Fred Metz continuing as general warehouse manager. The board accepted this plan and fully endorsed the recommendation of Ben Adams.

From the time he started in business for himself, Ben Adams had tried to select employees who were willing to work hard and attend strictly to their business. To further the plan for a close-working organization, the firm, although a closely held corporation, offered opportunities for the key personnel and the older employees to buy shares of stock. Frequently the firm went so far as to help the employees borrow money to buy stock by endorsing their notes at the bank. Throughout its years of operation, the firm had followed a strict policy of retention of earnings, which, by 1950, had allowed it to achieve a strong position financially. The use of a public bonded warehouse and warehouse receipts was a substantial factor in meeting earlier financial needs during periods of short capital within the firm.

From the beginning, Southern Foods had used road salesmen for their fresh fruits and vegetables. As food items were increased, special salesmen were used for food items alone. The same procedure was followed in the sale of beer, distilled spirits, and wine. Local option in the sale of alcoholic beverages restricted the sales of beer, distilled spirits, and wine to a market of 10 counties.

Quincy was a city of more than 50,000 people in 1950 and the area served by Southern Foods was nearly equally divided between urban and rural inhabitants. Over 30 percent of the population was nonwhite. Its area was somewhat typical of any other Southern trade area with the pulp and paper, petroleum, and cotton and other farming making up its major economic resources. Adequate water transportation plus good railroad, airline, and highway systems gave Southern Foods adequate facilities for incoming shipments. Although in its earlier years, a substantial part of its merchandise was delivered by train to its customers, in recent years all deliveries have been made from its own fleet of transport trucks.

In 1950, Southern Foods was handling about 700 grocery items, all of which were producers' or manufacturers' brands. Following the policy set forth by most beer manufacturers, Southern Foods had previously entered into an agreement to handle only one brand of beer for which they had the exclusive right of distribution in this area. In the counties in which the sale of beer was legal, this brand accounted for approximately 50 percent of the total beer sales.

Following World War II, Southern Foods experienced a substantial increase in all areas of its business. A part of this increase was attributed to the general postwar increase in business activity while substantial credit for the increase of this particular firm was attributed by its management to the intensive effort of both management and the employees to do an outstanding job. Orders were filled quickly, and the salesmen often assisted in the filling and the delivery of the orders.

In 1950 Southern Foods was concerned with either going into the grocery phase of its operation on a stronger basis, which might pose other problems, or continuing to treat the grocery operation mainly as a service to its customers. Should they decide to place greater emphasis upon their grocery items, other strategies would seem necessary and more specific plans would be required to give them the desired volume for their grocery items. A new location would necessitate adequate space for their trucking operation and availability of adequate railroad sidings. The initial investment for the real estate, plant, and equipment would pose a substantial financial problem for the Southern Foods people should they decide to move into a new location.

Southern Foods recognized that another problem might arise in the event they expanded their grocery business. Starting as a fresh fruit and vegetable firm, there was some question whether the firm might continue to be considered a fruit and vegetable house rather than a grocery firm, or whether it might even be considered as a beer, distilled spirits, and wine distributor with the grocery items being secondary. Other matters that concerned management at this time were along the lines of separating the present organization into new and separate firms rather than maintaining the entire organization as a single enterprise.

In June of 1950, Ben Adams was convinced that the time had come to take more positive action on the future of his business. His business had now reached the volume that his customers could not be served satisfactorily with the present plant and location. After discussing the matter with Tommy Jones, Ben Adams decided that the time had come to seek a new location. Tommy Jones endorsed this decision. Ben Adams and Tommy decided that, before making such a move, it would be well to visit other large fresh fruit and vegetable houses in order to get a better idea as to size of plant, layout, and other matters that would have a bearing on the success of their own business. With these objectives in mind, Ben Adams and Tommy Jones took a trip to visit a number of the larger fresh fruit and vegetable firms in the South, Southwest, and Midwest. It was during this trip that they saw a new type of operation.

Several large firms that handled both fresh fruits and vegetables and groceries, were visited in which the retail grocers were organized as a voluntary chain and the grocery business was handled on a "cost-plus" basis. A voluntary chain is a group of retailers, each of whom owns and operates his own store and is associated with a wholesaler to carry on joint merchandising activities. The members of the chain are characterized by some degree of group identity and uniformity of operation. Although this type of operation was not an entirely new idea to them, it had made little impression until they saw it in action. Tommy Jones was particularly impressed with the opportunity of selling groceries to the retailers at cost, plus the necessary charges for making the delivery from the wholesaler to the retailer and of giving the retailer the necessary services to enable him to remain in competition with the chain stores and other independents in this area. Although their trip had been instituted to study and formulate plans for a strictly new fresh fruit and vegetable plant, while continuing in the grocery business on a smaller scale, they became so enthusiastic over this new type of operation that they studied and observed it carefully and in detail. They directed their visits to several firms making use of the so-called "voluntary chain," and with each visit they became more and more convinced that this type of operation might have strong possibilities in their own case.

EXHIBIT 2

Selected Data for Counties Now Served and Those Areas Which Southern Foods Corporation Expect to Serve, 1948

Counties	*Population*	*Population Percent Increase 1940–50*	*Number of Families*	*Median Family Income (Dollars)*	*Total Persons in Labor Force*	*Percent Employed in Agriculture*	*Percent Employed in Manufacturing*	*Total Retail Stores 1948*	*Total Retail Sales 1948 ($1,000)*	*Total Retail Food Stores 1948*	*Total Sales Food Stores 1948 ($1,000)*	*Value Added by Manufacturing ($1,000)*	*Value of Farm Products Sold ($1,000)*	*Total Bank Deposits ($1,000)*
1	39,616	0.1	10,055	1,835	28,870	6.4	13.6	437	27,089	177	7,381	9,683	1,854	17,657
2	32,256	18.4	8,110	2,128	12,497	11.7	23.2	442	23,423	181	5,956	9,106	909	13,942
3	25,660	−4.2	6,195	1,810	8,621	37.8	13.4	225	11,104	81	2,949	12,797	4,811	744
4	7,132	−26.0	1,620	1,178	2,174	39.9	22.1	70	1,727	25	420		10,311	853
5	33,051	6.1	8,445	1,876	11,104	11.2	33.9	418	18,929	152	5,002	18,792	1,135	11,487
6	49,686	−1.5	12,660	2,315	17,405	9.3	27.7	695	38,510	226	7,686	27,468	1,630	32,276
7	18,835	7.4	4,570	1,810	5,617	19.6	27.8	204	7,619	70	1,464	4,091	2,395	20,157
8	38,031	−3.1	9,540	1,327	10,641	46.8	4.7	519	13,299	253	2,773	1,996	6,122	9,922
9	17,766	19.7	4,425	1,750	5,166	17.8	24.1	880	8,968	78	2,845	3,548	1,454	7,138
10	19,105	−20.2	4,535	1,387	5,719	34.9	21.0	222	6,765	89	2,063	2,646	1,877	4,297
11	40,139	21.0	9,645	2,364	10,423	24.6	12.2	324	16,379	134	4,362	5,230	4,855	8,819
12	176,547	17.5	45,375	2,638	66,902	7.4	11.3	1,743	170,289	9,367	34,942	31,081	8,891	168,754
13	10,293	−14.6	2,600	1,472	2,804	31.5	23.4	105	4,209	33	1,871	2,843	1,456	2,927
14	11,834	−19.0	2,760	1,276	3,279	53.0	5.9	114	4,129	46	1,277	245	2,582	1,760
15	25,063	−16.1	6,115	1,626	8,098	36.7	8.3	234	11,112	240	3,102	1,027	2,997	11,520
16	14,398	−1.1	3,285	1,265	4,481	41.8	9.3	131	4,907	54	1,698	823	2,096	3,526
17	24,398	−23.3	3,850	1,294	7,166	39.5	14.8	279	11,034	139	2,861	4,545	4,379	7,695
18	16,302	−14.3	3,930	972	4,756	59.1	4.6	126	6,552	47	1,477		4,242	2,420
19	31,629	3.7	7,590	1,331	8,908	47.7	7.4	426	9,386	442	1,997	2,653	7,052	5,353
20	26,376	−9.3	6,745	1,359	8,355	65.3	1.9	232	10,398	83	2,547	548	10,285	7,584

21	15,434	−13.3	3,735	1,994	4,592	12.5	42.5	136	7,846	49	1,625		479	3,554
22	12,717	16.0	3,285	1,799	3,058	10.5	19.6	151	6,352	57	1,601	1,557	420	3,878
23	17,451	−5.4	4,175	1,187	5,361	41.2	19.0	179	7,962	78	1,744	4,251	3,871	4,378
24	32,038	16.2	7,720	1,847	9,853	34.9	27.5	279	16,080	112	4,251		6,663	7,126
25	38,144	−7.0	8,200	1,159	10,022	40.6	8.5	331	11,905	146	3,265	2,142	5,304	9,697
26	74,713	26.3	19,350	2,434	26,984	6.4	16.3	957	75,073	344	12,573	25,646	3,736	40,167
27	90,648	23.5	21,665	1,964	27,519	11.7	13.1	976	58,673	381	13,199	13,643	7,180	47,218
28	12,113	−23.7	2,805	1,147	3,345	55.8	3.8	106	4,040	60	1,020	199	3,217	1,659
29	26,672	−7.5	6,015	1,338	7,727	56.8	3.3	255	12,513	81	2,713	515	7,026	5,486
30	20,880	−11.5	4,965	1,302	5,360	27.6	21.9	198	6,436	88	1,664	3,513	1,450	4,327
31	13,209	−17.1	2,955	964	3,995	57.7	4.1	126	4,869	65	1,198	423	4,041	3,244
32	19,141	−8.6	4,540	1,604	5,364	34.2	21.1	182	7,586	54	1,310	2,199	2,076	5,610
33	18,974	−0.9	4,665	1,281	5,083	30.9	17.0	234	7,627	112	2,582	946	1,053	4,856
34	35,704	6.0		8,620	10,712	15.4	25.3	415	21,460	147	5,587		2,221	9,954
35	17,248	−10.4	4,085	1,173	4,616	67.2	2.6	132	5,950	57	997	195	4,345	2,523
36	16,119	−4.8	4,040	1,487	4,517	16.8	26.3	143	6,361	59	1,618	2,542	715	1,850
37	25,782	4.0	5,765	1,806	7,757	26.5	8.7	217	12,102	67	2,164	1,709	1,756	

Source: U.S. Department of Commerce, Bureau of the Census, "County and City Data Book," 1952, a *Statistical Abstract* supplement.

Immediately upon their return to Quincy, Ben Adams asked Tommy Jones to take all of the material and information they had gathered on their trip and, in consideration of their present business and future possibilities, to present his findings to the board as soon as possible.

Tommy Jones made a study of the area now served by Southern Foods Corporation as his first step. His findings are shown in Exhibit 2. He then made a study of other regions to see if any conclusions might be drawn which would reflect the degree to which this new voluntary chain type of operation might be effective. The summary of these data for other regions is shown in Exhibit 3.

During their trip, Ben Adams and Tommy Jones became enthusiastic over several developments in food distribution through the voluntary chain type of operation. First of all, there was a higher degree of processing by food manufacturers, which has materially lightened the work of the housewife. Second, they observed improvements in food handling, packaging, preserving, transporting, storing, and distribution methods generally. Third, they noted a continuing shift from separate meat, produce, and grocery stores to a one-stop store. Fourth, they became aware of replacement of smaller stores by supermarkets and location of markets in new shopping centers. Fifth, they observed greater gains by food chains and organized groups of independent retailers than by unaffiliated stores. And sixth, they took note of the spread of self-service throughout food retailing.

One of the procedures noted by Ben Adams and Tommy Jones on their visits to wholesalers sponsoring a voluntary chain was the ordering procedure. In these voluntaries, they noted that the wholesaler sent out a weekly price list in the form of an order blank, and the retailer checked the quantity of the items he wanted and mailed the order in to the wholesaler, along with a signed, blank check in payment for the order. This saved the expense of the salesman's calling on these customers each week to get their orders, saved the retailers the time with the salesmen—which was often during their busier hours of the day, and eliminated the accounts receivable and billing expenses of the wholesaler. These savings were passed back to the retailer to give him a lower intial cost of his purchases, thus enabling him to price his goods more competitively. To implement this program, the sponsoring wholesalers they visited made use of specialists who called upon the retailer-members to help them with their merchandising, advertising, layout, financing, and other problems.

Further research by Tommy Jones in publications of the U.S. Department of Commerce and the numerous trade publications revealed that the expenditures for food as a percentage of disposable income over the period 1939 to 1949 ranged from a low of 20.2 percent to a high of 25.5 percent, and in only four of the 20 years prior to 1950 had the figure been below 21 percent. This was during World War II when the figure dipped into the 20 percent area. This relative stability of the food busi-

EXHIBIT 3

SELECTED DATA FOR UNITED STATES AND THE FOUR REGIONS, 1948

Counties	*Population*	*Population Percent Increase 1940–50*	*Number of Families*	*Median Family Income (Dollars)*	*Total Persons in Labor Force*	*Percent Employed in Agriculture*	*Percent Employed in Manufacturing*	*Total Retail Stores 1948*	*Total Retail Sales 1948 ($1,000)*	*Total Retail Food Stores 1948*	*Total Sales Food Stores 1948 ($1,000)*	*Value Added by Manufacturing ($1,000)*	*Value of Farm Products Sold ($1,000)*	*Total Bank Deposits ($1,000)*
A........	150,697,361	9.7	38,310,981	3,083	56,239,449	3.3	34.3	1,769,540	130,520,548	504,439	9,870,703	74,425,825	22,052,256	145,931,249
B........	44,460,762	10.8	11,547,110	3,277	17,225,904	13.8	29.0	529,565	421,699,972	129,918	9,269,716	27,592,972	9,734,646	39,236,125
C........	39,477,986	9.7	10,095,790	3,365	15,449,372	3.3	34.3	516,487	36,732,605	156,872	9,870,705	27,604,426	1,922,353	64,239,704
D........	47,197,088	13.3	11,546,430	2,248	16,498,650	19.7	18.4	505,247	32,114,007	1,346,893	7,346,893	12,845,191	6,358,668	24,033,940
E........	19,561,525	40.9	5,121,650	3,402	7,065,523	10.6	17.5	224,241	19,503,964	4,478,360	4,478,360	6,383,236	4,063,598	18,421,480

A = United States.
B = North Central States.
C = Northeastern States.
D = South.
E = West.

Source: U.S. Department of Commerce, Bureau of the Census, "County and City Data Book," 1952, a *Statistical Abstract* supplement.

EXHIBIT 4

Selected Data of Southern Foods Corporation's Trade Area

County	Estimated Population July 1, 1959*	Estimated Households July 1, 1959*	Consumer Spendable Income per Household for Year Ending July 1, 1959*	Total retail Sales per Household for Year Ending July 1, 1959*	Food Stores†	
					Establishments (Number)	Sales ($1,000)
1	40,600	12,570	$4,770	$3,475	142	$11,549
2	37,100	10,470	5,492	3,637	93	10,275
3	16,000	4,260	5,130	3,528	62	4,636
4	4,700	1,280	2,545	2,092	22	1,134
5	32,700	9,140	3,340	3,065	125	6,895
6	46,500	13,790	4,517	3,906	161	12,092
7	21,300	5,890	4,255	2,687	56	3,614
8	38,500	10,680	3,183	2,202	157	5,313
9	21,800	6,270	3,452	1,882	55	3,844
10	16,300	4,430	3,683	1,753	35	1,999
11	49,800	13,120	4,761	3,125	105	9,455
12	21,900	62,140	5,933	4,151	429	57,770
13	9,600	2,680	2,219	1,938	37	1,631
14	10,400	6,090	4,951	2,134	32	1,601
15	22,600	3,830	4,195	2,683	41	3,400
16	15,300	4,370	4,637	2,830	47	2,711
17	19,700	5,340	5,340	3,879	69	3,933
18	15,200	4,120	3,573	1,725	31	2,171
19	35,300	10,050	3,258	1,380	103	2,205
20	29,200	7,390	3,421	1,695	73	4,268
21	14,400	3,960	3,364	6,171	49	2,575
22	15,200	4,470	3,379	3,513	40	2,397
23	18,000	5,080	2,918	2,194	54	2,695
24	38,900	10,500	3,624	1,841	66	5,975
25	38,700	10,600	3,194	1,676	87	5,162
26	90,300	26,490	5,532	4,143	243	21,066
27	107,600	28,530	4,057	2,947	248	25,700
28	9,700	2,620	2,820	2,150	40	2,263
29	26,800	6,720	3,309	1,949	74	3,309
30	20,000	5,400	2,610	1,820	44	1,661
31	11,800	3,380	2,809	1,441	29	1,102
32	19,100	5,160	2,879	1,826	53	2,348
33	20,400	5,840	3,741	2,163	48	4,563
34	40,300	11,070	3,076	2,439	116	9,076
35	10,900	4,230	3,112	1,290	38	1,442
36	17,300	5,050	2,729	1,818	42	3,378
37	26,400	6,720	4,707	2,867	60	4,717

Sources:
* Standard Rate and Data Service, Newspaper Rates and Data, April 15, 1960.
† U.S. Department of Commerce, Bureau of the Census, Retail Trade, 1958 Census of Business.

ness, plus the fact that lower income groups tend to spend a larger percentage of their income for food was of further interest to Tommy Jones.

In 1950 there were two national chain store groups operating in the area being served by Southern Foods; however, the extent of their operation was quite limited. There were no retailer cooperatives and no wholesaler-sponsored retail groups in the area.

In 1950, the approximately 41 wholesale grocers operating in the area being served by Southern Foods were for the most part very small, and their operation seemed costly and inefficient. Most of these wholesalers would not offer strong competition to the proposed voluntary chain.

Over the preceding decades there had been substantial resentment of the national chain store type of operation, particularly in foods, in many sections of the South. There was some evidence that this resistance was weakening and that in the future substantial expansion of the chains in this area might become a reality. It was evident that, if the wholesaler were to survive, he must be able to meet such competition.

As Tommy Jones reviewed his firm's operations, he made some observations which he felt were significant. He believed that the market for distilled spirits and wines, presently a substantial one, did not afford an opportunity for great future expansion. On the other hand, he felt that the sales of beer might continue to show an increase since many people might not look upon the consumption of beer in the same light as other alcoholic beverages. As he considered the grocery phase of the business, he felt that with making grocery items available to the retailers at the costs apparent under the new "cost-plus" plan, his firm could greatly expand this part of the business. The growth of the frozen food industry also appeared as a new opportunity which should have good possibilities. The shifting demand of the consumer for more fresh fruits and vegetables on a year-round basis made this area of operation a promising one for the future. Tommy Jones was optimistic over the future of the Southern Foods operations under the voluntary chain plan of operation.

The large number of smaller retail food stores made the costs for personal selling and servicing a substantial figure. Concentrating Southern Foods business with a selected group of larger firms appeared to be a much more profitable operation. However, the contribution of buying by the smaller stores to the total quantity of goods purchased by Southern Foods, and the better prices through large volume purchases raised the question of discontinuing this business with the smaller stores.

Tommy Jones became aware of the fact, through further research, that although the voluntary movement seemed to be gaining in some areas throughout the country, it had been relatively weak in penetrating the grocery field in the South. Research revealed that such a movement had been most frequent when (1) associated with larger metropolitan areas, and, (2) given more favorable inducement by legislation. In previous years, and particularly in the South, the attempt to meet the chain store competition had been in the form of attacking the chain as an undesirable element in the community. This was attempted through casting the chain as a "pirate" who took the income out of town and delivered it to distant communities. In the meantime, the private retailer was placed in the "good citizen" category whose entire effort was to contribute to the betterment of his home community. A new approach to make the independent retailer competitive with any chain competition could be accomplished, thought Tommy Jones, through maintaining good quality products, lower distribution costs, reduced prices, and complete services.

Tommy Jones selected certain data from the Bureau of the Census figures to obtain a clearer picture of the Southern Foods trade area and of any apparent relationship with other areas. These figures are shown in Exhibit 2. Tommy Jones had become aware of the fact that the voluntary chain movement was in progress in other parts of the country, but there was a question as to whether the makeup of the Quincy area presented any significant differences from other areas which would indicate the potential opportunity for success of a voluntary chain type of operation by Southern Foods. The data in Exhibit 3 affords an opportunity for comparison of the four major regions in the United States. The data in Exhibit 2 confirmed the knowledge Tommy Jones had of the Quincy area in many respects, but in a few instances the figures revealed facts that brought the proposed expansion of the store into a different light. For example, Tommy Jones was not fully aware that the Quincy trade area had such a large number of small food stores, or that the median family income was so much lower for this region than for other regions. The question arose as to what communities in this area could support a voluntary chain. In the event the company organized a voluntary chain with the larger retail stores, would there be sufficient resentment on the part of the smaller stores that they would discontinue doing business with Southern Foods? If Southern Foods attempted to induce larger retailers to handle its lines of distilled spirits and wines, along with groceries and fresh fruits and vegetables, would this move be acceptable to the household consumer? Tommy Jones was aware of the fact that Quincy was in the so-called "Bible belt" and that there might be some feeling in this area concerning the association of alcoholic beverages, groceries, and produce that might not prevail in other regions.

After Tommy Jones had had the opportunity to summarize the findings of their recent trip and add to this such data as he felt pertinent concerning the Quincy trade area, he made a preliminary report to Ben Adams. Ben Adams and Tommy Jones were not now as convinced of the soundness of their earlier consideration to move in the direction of establishing a voluntary chain of retailers as they were immediately after their return from their trip.

"For one thing," stated Ben, "we are in a 'different' type of community from some of those we visited in which the voluntary chain seems to be successful. Our retail grocery customers may lack some of the aggressiveness necessary for this type of operation, and from your report, we do not have the per family spending power that some other communities may have. We have built a good business, as our sales figure for 1950 show, with these small firms, and I'm wondering what will happen if we start promoting larger retailers and giving them benefits we cannot give the smaller firms."

"Yes," replied Tommy, "you have built a very fine business by giving these customers good merchandise and service. It appears to me that, if some of the larger retailers in our area realize the added benefits and increased profits that can accrue to them by giving us a major portion of their purchases, they would be interested in joining with us. In this way, we should substantially increase our sales among the larger stores, and perhaps continue to serve our smaller customers too. I believe a program of mutual benefit can be worked out."

"Perhaps you are right, Tommy," replied Ben. "I will call a board meeting for next Tuesday morning and ask you to present your findings to the board. You may wish to conclude your remarks with some recommendations." The board met, as scheduled, at 9:00 A.M. in Ben Adams' office.

At the meeting of the board of directors on Tuesday morning (and subsequent meetings to complete this business), the following decisions were made:

1. To find a site in Quincy and build a complete new plant and handle a full line of produce.
2. Add a full line of frozen foods and groceries.
3. Add health and beauty aids.
4. Add tobaccos.
5. Promote a voluntary retail cooperative contract plan for the independent retailer, including complete merchandising and advertising services.
6. Form a separate corporation for the handling of beer.
7. Form a separate corporation for the handling of distilled spirits and wine.
8. To continue to sell to nonmember stores.
9. To continue their policy of quality merchandise and efficient service to all retail customers.
10. To continue their personnel policy of promotions from within the organization insofar as possible to do so.

The decision to find a new site in Quincy and build a complete new plant met with no resistance. A team of professional consultants was employed to make the survey for the new location and draw up plans for the new building. After several months, a new site, consisting of nearly 18 acres was acquired which afforded good railroad sidings, and which was satisfactory for all trucking operations. The building plan called for 100,000 square feet, all on one floor, to be constructed to accommodate efficient handling of merchandise with all modernized equipment within the plant. The plant was to be constructed to handle both incoming and outgoing shipments most efficiently and economically. IBM equipment was to be installed for use at the beginning of the new plant operation. The property on Lee Street was valued at about $235,000. The cost of the new plant including real estate was estimated at $615,000. The property on Lee Street was sold and this revenue, plus that from the sale of some other holdings by Southern Foods was applied to the purchase of the new property. The additional money was borrowed from four banks on a five-year loan to complete the transaction.

The decision to add a full line of frozen foods and groceries was preceded by substantial discussion, hinging around the potential sale of these items. Some of the board members felt that the other smaller wholesalers in the Southern Foods trade area might be sufficiently established in their immediate community that it would be difficult to meet this "local" competition. Tommy Jones pointed out that the apparently strong obligation of the head of the household to the family needs of good food for less money is becoming stronger than holding to an "ideal" of loyalty to a local institution. The plan for the establishment of the voluntary group was brought in here sufficiently to show the means of expanding the grocery sales to a much more profitable volume. Ben Adams, too, felt that this phase of the business, originally entered into as a service, now appeared sufficiently important to become a major phase of company operations. Particularly so with the opportunity to make grocery products available to the retailer members of the chain at prices which could not be met profitably by other independent wholesalers.

The frozen food phase of their new operation was looked upon as supplementing the grocery line and the produce line, and as another means of meeting the growing trend among larger retail stores for a complete food service operation. With the increasing trend in sales of household refrigeration units, frozen foods were looked upon as another profitable means of expanding the operations of Southern Foods.

The decision to add health and beauty aids and tobacco products was another part of the plan to make Southern Foods as nearly as possible a complete servicing wholesaler for the members of the retail grocery chain and for the other customers also. Tommy Jones had noticed that the larger retail grocery stores now carried a sufficient line of tobacco products, and his research showed that over 96 percent of these grocers carried a very substantial inventory of health and beauty aids. Although the wholesalers' markup on tobacco products is relatively low, failure to include these items would necessitate Southern Foods' customers making these purchases from other sources. The wholesale firms visited pointed out that the retailers' markup on health and beauty aids was such that most retailers want to carry a rather complete line of these products. The markup for the wholesaler is sufficient to enable him to realize a very satisfactory profit on these items.

The decision to promote a voluntary retail chain was preceded by a detailed explanation of the organization and operation of such a chain. Tommy Jones gave a substantially detailed account of the plan for organizing a voluntary retail chain. He discussed the profit opportunity for the retailer in affiliating with such a group, and the added profits to the sponsoring wholesaler through such a plan. Substantial concern was evidenced concerning the role of the small retailer and the question of whether he would eventually be eliminated as a customer. It was pointed out that the contribution of the many small retail grocery customers to the volume-buying economies of Southern Foods should not be overlooked, at least for the present.

The buying procedure for members of the voluntary chain was outlined by Tommy Jones. Southern Foods would send each member store a price list showing every item handled. This list would show the cost, a suggested retail price with the gross margin to the retailer indicated, and would provide space for the retailer to indicate the quantity of each item he wanted. This order book would be sent back to Southern Foods, along with a signed blank check. Upon completion of the order, Southern Foods would compute the amount of the order and fill in the check. Southern Foods would maintain a fleet of delivery trucks, with all orders being filled at night. Orders would be delivered to the retailers the following morning. Orders from nonmembers would be taken by the salesmen, frequently called in and recorded by mechanical equipment and filled and delivered similar to those of member stores. Regular scheduling of deliveries would provide economical operation of this phase of the business. The invoices from Southern Foods suppliers would be available for inspection by any member store at any time. This policy should preclude any suspicion the member stores might have in the pricing procedure of Southern Foods.

In clarifying the plan for organizing the voluntary chain, Tommy Jones pointed out the economy of having the members send in their orders, which would eliminate the cost of the salesmen. (A copy of the contract for members of the voluntary chain is shown in Exhibit 5.) By inducing the members to operate on a strictly cash basis, the cost of maintaining accounts receivable and of billings would be eliminated. To make these members more competitive, Tommy Jones explained the plan for a complete merchandising and advertising service for them. This service would be maintained on a strictly cost basis and would include planning store layouts, arrangement of merchandise, redesign of the store, and such other services which would promote the store and the sale of its merchandise.

Two specialists would be employed whose sole function would be that of rendering complete merchandising and advertising service to the member stores. These specialists would visit the member stores on a regular schedule to give the retailer whatever promotional assistance he needed. Many new ideas in the display and promotion of food items were coming in and with the individual retailer being occupied with meeting customers and the other details of a store manager, the Southern Foods people felt

EXHIBIT 5

SOUTHERN FOODS CORPORATION
Wholesale Grocers
Quincy, Dixie

Cypress Shopping Center Co-operative Food Store
Membership Application and Agreement

THIS AGREEMENT entered into between the Cypress Shopping Center Food Stores, division of Southern Foods Corporation, Quincy, Dixie, and the undersigned Independent Retail Grocer
WITNESSETH:

The undersigned Independent Retail Grocer hereby makes application for membership in the Cypress Shopping Center Co-Operative Stores effective upon approval, beginning on ——— and agrees to pay membership dues in advance amounting to $30.00 FOR EACH PERIOD OF FOUR WEEKS: to cover buying and merchandising privileges, market and information services, including a complete grocery cost and order book issued weekly.

All membership dues must be prepaid for three periods.

WHEREAS, it is the desire of the Wholesaler to reduce cost of operation to a minimum and to pass the benefit of operating cost reduction to the Retailer; and

WHEREAS, it is the desire of the Retailer to pass these reduced prices on to his retail customers.

NOW, THEREFORE, in consideration of mutual promises made and entered into between the Wholesaler and the Retailer, it is agreed that upon acceptance of membership—

THE WHOLESALER WILL—

(1) Operate and maintain a warehouse of sufficient size and arrangement to carry and efficiently handle
  A. Groceries
  Which shall include Sundries, Drugs and Candies, Paper Products, Tobacco, Cigarettes and other products generally classified under the term "Groceries."
  B. Fruits and Produce
  Fresh Fruits and Vegetables, Produce and other products
  C. Frozen Foods and Dairy Products
(2) Invoice to the Retailer all grocery merchandise at cost, f.o.b. Quincy, except products on which the price is fixed by law.
(3) Handle and deliver grocery merchandise to the Retailer for
  3¾% of invoice total, within the Quincy City Limits, except certain "Traffic Items" outlined elsewhere.
  4¼% of invoice total, beyond the Quincy City Limits, except certain "Traffic Items" outlined elsewhere.
  3% of invoice total on Baby Foods.
  5% of invoice total on Health and Beauty Aids, School Supplies.
  1¼% on "Traffic Items" within the Quincy City Limits.
  1¾% on "Traffic Items" beyond the Quincy City Limits.
(4) Invoice all produce, perishables and other merchandise handled by the Produce Department at the lowest possible flat delivered prices.
(5) Employ adequate field Merchandising Men to work with the retailer.
(6) Distribute to Cypress Shopping Center Food Stores certain designated savings accumulated through co-operative action. Such savings will be made possible through the member's co-operation with the plans and promotions of the organization.

EXHIBIT 5 (*Continued*)

Amounts due from such savings shall be deducted from purchase invoices.

THE RETAILER WILL—

(1) Maintain his membership on a prepaid basis in the Cypress Shopping Center Co-Operative Stores. Co-operate in the program of the organization. Feature products selected for special display and sales promotion. Purchase from or through the Wholesaler merchandise handled or recommended by him, in all departments, including Dry Groceries, Fresh Fruits and Produce, Frozen Foods, Dairy Products, Ice Cream, Health and Beauty Aids, Housewares, Hosiery and other lines.

(2) Avail himself of and use in good faith to the best of his ability signs, insignias, emblems, etc., as recommended for the members, also refrain from displaying other signs, insignias, emblems, etc., which would conflict.

(3) Use the order form furnished weekly by the Wholesaler; make up his order and have it in the Wholesaler's office at the time specified.

(4) Recognize the Wholesaler's right to select its customers and, further, recognize that there is no obligation on the part of the Wholesaler to continue to sell merchandise to the Retailer under its own labels or any other label after the termination of this agreement.

This Agreement shall continue in full force and effect until cancelled by either party upon written notice given two periods in advance of cancellation date. In the event of cancellation by the Wholesaler, the unused portion of prepaid membership and accumulated credits will be paid to the Retailer on the date of termination.

Dated at Quincy, Dixie, this _____ day of _______, 19___.
Cypress Shopping Center Co-Operative Food Stores,
Division of Southern Foods Corporation
By ______________________________
Wholesaler
RETAIL MEMBER
By ______________________________
Owner

Store Name
Street Address
City or Town
Telephone Number
Bank Connection
Check _____ Draft _____

NOTE: Traffic Items, as defined in Brochure, include:
All Soaps and Detergents
All Milk, Canned and Powdered
All Coffee, Ground and Instant
All Sugar, Including Powdered and Brown
All Shortening and Pure Lard

that this service would meet with the approval of the members of their chain.

Noting that other voluntaries used a name for their chain, the Southern Foods' board was quick to go along with this idea and decided that the new chain would be called the Cypress Shopping Centers.

The decision to form a separate corporation for the handling of beer and distilled spirits and wine was made as a means of facilitating the financial and organizational procedure, rather than for sociological reasons. To effect this phase of the business, each of these two newly formed corporations was headed by the president and chairman of the board of Southern Foods, with the general manager of Southern Foods assuming the same position in each of these two new corporations.

In discussing the establishment of the voluntary chain, some difficulty was experienced in estimating the number of members necessary to support such a chain on a profitable basis. To determine the size of the physical plant, and also to appraise the potential for the voluntary chain, Tommy Jones made a list of the principal independent grocery stores in each town and estimated their retail sales. He then took 60 percent of this as what Southern Foods could expect to supply. He then took 80 percent of this figure to arrive at an estimated sales figure for Southern Foods.

Further research by Tommy Jones revealed that some voluntaries were operating with no more than 25 or 30 members, while others had more than 100 members. It was believed that at least 40–50 and probably many more retailers could be organized, which would leave approximately 800 nonmember customers. The contribution toward volume buying of these 800 nonmembers was believed to be too great to consider eliminating them in the near future. It was planned to continue selling to them through Southern Foods field sales force and making quality merchandise available to these nonmembers at the best possible price.

Southern Foods had followed a policy of handling only a good quality product and manufacturers' or large distributors' brands which had gained an acceptable market in this area through national advertising and the merits of the product. The board believed that a promotion program essential to gain satisfactory acceptance of the company's own brands would be too costly at least for the present. Tommy Jones pointed out that this area seemed to be one in which even the lower income groups wanted a better quality food product.

The organizational structure of Southern Foods for 1950 is shown in Exhibit 6. With the establishment of the voluntary chain group and the addition of a full line of grocery products, some changes in the structure, primarily expansions to accommodate the added goods and services as planned under the new setup, were necessary. The new organizational structure, including these additions, is shown in Exhibit 7.

The board recognized that entering into this new type of operation might bring new problems, heretofore unfamiliar to their present staff. It was felt by Ben Adams that the personnel now affiliated with Southern Foods were sufficiently well qualified and flexible to learn the necessary new techniques to administer this program effectively. The other board members agreed. Ben Adams again reaffirmed his policy of maintaining a high degree of employee loyalty by making all possible promotions from within the present group.

The new warehouse was opened for business in the summer of 1953. Immediately upon completion of the physical plant, Tommy Jones began the organization of the voluntary chain. An unexpected problem developed in selling the cooperative idea to the retailers. In the planning stages for this cooperative group, it was expected that a large number of retail grocers would be interested in this idea. However, interest among the retailers turned out to be limited because of satisfaction with their present operations and a lack of concern over building their retail firms into a stronger and more competitive store for the future. Tommy Jones noted that those owners and managers who had had some experiences with large chain stores were most receptive to the voluntary chain idea. Through a great deal of personal promotional effort by Tommy Jones, membership in the voluntary chain grew. Southern Shopping Centers appeared in many cities and towns in the area served by Southern Foods.

EXHIBIT 6

Organizational Structure of Southern Foods Corporation, 1950

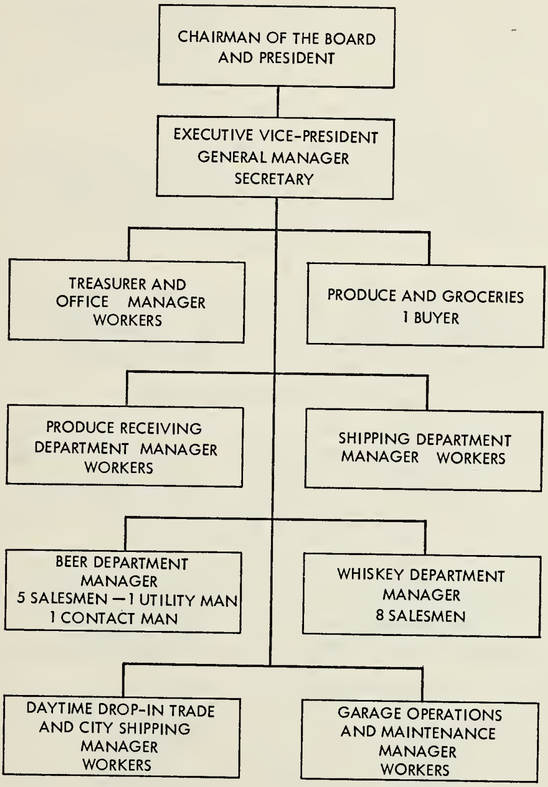
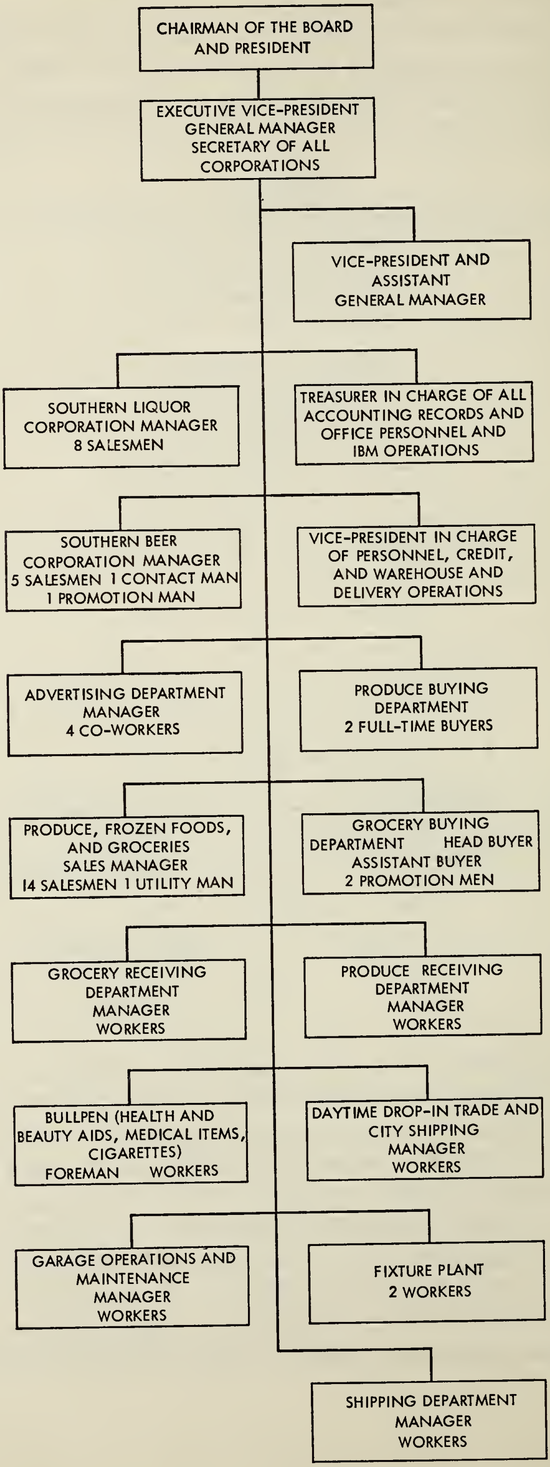

CHAIRMAN OF THE BOARD AND PRESIDENT
EXECUTIVE VICE-PRESIDENT GENERAL MANAGER SECRETARY
TREASURER AND OFFICE MANAGER WORKERS
PRODUCE AND GROCERIES 1 BUYER
PRODUCE RECEIVING DEPARTMENT MANAGER WORKERS
SHIPPING DEPARTMENT MANAGER WORKERS
BEER DEPARTMENT MANAGER 5 SALESMEN — 1 UTILITY MAN 1 CONTACT MAN
WHISKEY DEPARTMENT MANAGER 8 SALESMEN
DAYTIME DROP-IN TRADE AND CITY SHIPPING MANAGER WORKERS
GARAGE OPERATIONS AND MAINTENANCE MANAGER WORKERS

EXHIBIT 7

Organizational Structure of Southern Foods Corporation, and the Beer and Whiskey Corporation, 1953


CHAIRMAN OF THE BOARD AND PRESIDENT
EXECUTIVE VICE-PRESIDENT GENERAL MANAGER SECRETARY OF ALL CORPORATIONS
VICE-PRESIDENT AND ASSISTANT GENERAL MANAGER
SOUTHERN LIQUOR CORPORATION MANAGER 8 SALESMEN
TREASURER IN CHARGE OF ALL ACCOUNTING RECORDS AND OFFICE PERSONNEL AND IBM OPERATIONS
SOUTHERN BEER CORPORATION MANAGER 5 SALESMEN 1 CONTACT MAN 1 PROMOTION MAN
VICE-PRESIDENT IN CHARGE OF PERSONNEL, CREDIT, AND WAREHOUSE AND DELIVERY OPERATIONS
ADVERTISING DEPARTMENT MANAGER 4 CO-WORKERS
PRODUCE BUYING DEPARTMENT 2 FULL-TIME BUYERS
PRODUCE, FROZEN FOODS, AND GROCERIES SALES MANAGER 14 SALESMEN 1 UTILITY MAN
GROCERY BUYING DEPARTMENT HEAD BUYER ASSISTANT BUYER 2 PROMOTION MEN
GROCERY RECEIVING DEPARTMENT MANAGER WORKERS
PRODUCE RECEIVING DEPARTMENT MANAGER WORKERS
BULLPEN (HEALTH AND BEAUTY AIDS, MEDICAL ITEMS, CIGARETTES) FOREMAN WORKERS
DAYTIME DROP-IN TRADE AND CITY SHIPPING MANAGER WORKERS
GARAGE OPERATIONS AND MAINTENANCE MANAGER WORKERS
FIXTURE PLANT 2 WORKERS
SHIPPING DEPARTMENT MANAGER WORKERS
]

The Southern Foods Corporation gave the new members of its voluntary chain a great deal of help in planning stock, in remodeling stores, and in setting up an overall operation. This included assistance in purchase of refrigeration and other equipment at the lowest cost figure to the retailer. Of particular benefit to the Cypress members was the financial assistance extended them by Southern Foods in endorsing their notes for bank loans and other extensions of credit.

Another unexpected development arose with the new operation, namely, that of buying from certain manufacturers. The policy of certain grocery and tobacco manufacturers is that of restricting their wholesale outlets in a community to give the distributor a sufficient volume of business to make it a mutually profitable relationship. Southern Foods discovered that, although its new operation would be the largest in its trade area, the company was unable, initially, to secure certain branded goods at the time its new plant was opened. In some instances it was not until a few years later that certain manufacturers were willing to sell to them when there were other wholesalers in the trade area previously handling the same product.

Two additions to the organization of Southern Foods were to play a substantial role in building up the voluntary chain. One of these was the advertising department, which afforded the participating members the benefit of display materials and other promotional items which had not been available to them as independent grocers. The second addition was a fixture plant which the Southern Foods people staffed with skilled carpenters to build gondolas and shelvings, and to make the changes in the stores' display counters needed to bring these stores up to the high standards desired for members of the chain. These two services, advertising and fixtures, were "plus" features that contributed substantially to increased sales and profits for the new members.

With the Cypress Shopping Center stores well established by 1957, Southern Foods decided to expand operations by sponsoring a new type of chain in which all members would carry the name "Southern Belle" stores. To become a member, the store had to be a member of the Cypress group. Other requirements included 4,500 square feet of selling space, adequate parking, and a modern, clean, well-lighted store. Southern Belle stores were also required to carry a full line of goods. To carry this prestige name, the retailer had to take the initiative in seeking membership in Southern Belle. By 1961 these stores were strong retailers, although early in 1960 only seven stores were in operation.

The management of Southern Foods was constantly alert for any trends or developments which might have a bearing on the future of the business. The biennial grocery studies of *This Week* magazine, the information supplied through *Progressive Grocer*, and other trade publications, along with developments in the Southern Foods trade area, were watched closely. In the spring of 1960, Tommy Jones made a few notations concerning the status of the firm at that time and as of 1949. The following figures were of particular interest in this comparison:

	1949		*1959*	
	Sales	*Customers*	*Sales*	*Customers*
Distilled spirits and wines	$1,529,605	375	$ 1,143,248*	350
Beer	1,206,034	713	2,473,906	711
Produce	3,173,245	900	3,242,404	900
Groceries	600,000	900	8,727,856†	900
Frozen foods	none		660,518‡	
Totals	$6,508,884		$16,247,932	

* Lost main line of nationally known brands in 1955.
† Voluntary group started in fall of 1953.
‡ Frozen foods added in fall of 1953.

Several things about these figures were of interest to management. The decrease in the sale of distilled spirits and wines was partially accounted for by the loss of the company's main line of a nationally known brand in 1955. Southern Foods were pleased with their beer sales and were not disappointed with their present sale of distilled spirits. The volume of dollar sales in frozen foods was satisfactory and supported the decision to handle this line. The limited increase in the sale of produce was somewhat disappointing, particularly in consideration of the finer displays of these items in the Cypress stores.

Of great interest to management was the volume of sales attained in the grocery department. The expansion of food items handled from 600 in 1949 to 4,500 in 1959 and the emphasis among the members of the chain on buying most of the company's grocery items from Southern Foods explains part of this rise. Included in the grocery group of 6,500 items are 2,000 health and beauty aids. In most retail stores, these items account for about 2–3 percent of the total sales, although net profit on them is substantially higher.

A further analysis of the present sales by Southern Foods reveals that the 112 present members of the Cypress Shopping Center chain account for about six times the dollar volume of purchases of those made by the 900 nonmember customers. The average purchase per week of the 112 members of the chain is about $1,000, while the average for the approximately 900 nonmembers is about $35. The average markup obtained by Southern Foods from their Cypress chain members is about 3.4 percent above cost, while that for nonmembers is about 7.5 percent above cost.

The net profit on sales achieved by Southern Foods is about 0.78 percent which is above the average, as shown in *Dun's Review and Modern Industry* (November, 1959, p. 57). Management feels that the company's competitive position is strong in its trade area; however, since 1950, three more national chains are operating in this area. During this nine-year period, however, only one other voluntary chain has been organized, and there are about 14 fewer wholesale grocers operating in the area; only a few of those remaining now handle fresh fruits and vegetables.

In 1957, upon the death of Ben Adams, his son John was promoted to president and chairman of the board. No other changes were made in administrative personnel at that time. Shortly before Ben Adams' death, plans were made to expand the warehouse by 20,000 square feet of floor space. This addition was completed in 1958. By 1960 the area served by Southern Foods had been extended slightly, although the prime basis for increased sales stemmed from a greater saturation of its market area. The overall success of the venture into the voluntary chain of Cypress Shopping Centers was beyond expectations. Now, early in 1960, it was believed that any attempt to saturate further the present market area offered limited possibilities. Other wholesale grocers in the area were not looked upon by Southern Foods as strong competitors, although many of them appeared to have established a rather permanent clientele. Some of the members of Southern Food's board had wondered if the acquisition of certain of these wholesalers and setting them up as a branch of Southern Foods as a cash and carry type of operation might be advisable.

In consideration of the encroaching chain competition in the area, there was the question of Southern Foods' establishing its own private brands in some goods. Another suggestion in this same area was that of acquiring or controlling some sources of supply.

Another consideration that had been mentioned by individual members of the board was to acquire control of the members of the Cypress Shopping Centers, which had been operated up to this time as independent retail stores. Along this same line was the mention of making Southern Foods a strictly voluntary group and discontinuing selling to the independent grocers. This move, it was thought, might bring in some of the larger independents into the voluntary chain and would eliminate the smaller sales to the others. No mention was made in such conversations of discontinuing sales to the company's institutional customers.

The management of Southern Foods felt that operations had been quite successful since the organization of the voluntary chain group (See Exhibit 8). However, changes in the distribution of food, changing consumer buying habits, economic and social changes in the community served, and the future of their own business was of constant concern to them. Several acres of the land purchased in 1950 for the company's new location were not being used in Southern Foods warehouse operations in 1960. A few small business establishments were located on parts of these premises, though a substantial area was unused. The balance sheet revealed a substantial retained earnings figure, the result of Southern Foods policy of "plowing back" a substantial part of their earnings into the firm. Tommy Jones was quite interested in this figure and the "Cash in Bank" as a factor in any changes that might be made concerning Southern Foods' operations during the 1960's.

To appraise the company's present position and relate it to such future changes and policies as would enable them to maintain a successful operation demanded a vigilant attitude on the part of management. John Adams, at the suggestion of Tommy Jones, called a meeting of the board, for early in June, to appraise the present position of Southern Foods and to discuss any policy changes that should be considered at this time. Tommy Jones was asked to apprise the board of the present status of Southern Foods, and to bring to the meeting such suggestions and recommendations as he felt appropriate. The board met, as scheduled, at 9:00 A.M. on June 7.

EXHIBIT 8

SOUTHERN FOODS CORPORATION
and Subsidiaries
Consolidated Balance Sheet
December 31, 1959

ASSETS

Current assets				
Cash:				
On hand		$ 9,835.00		
In banks		871,722.89		
		881,557.89		
Less: Vouchers payable		597,106.96	$ 284,450.93	
Notes receivable—Trade		14,893.82		
Accounts receivable—Trade		347,145.31		
Accounts receivable—Employees		1,995.46		
		364,034.59		
Less: Allowance for bad debts		18,624.53	345,410.06	
Merchandise inventories			1,164,672.54	
Prepaid purchases			35,366.00	
State liquor stamps			7,281.91	
Warehouse receipts			28,442.71	
Prepaid expenses			39,521.10	$1,905,145.25
Investments				
Corporate stocks and partnership interest				20,750.00
Fixed assets	*Cost*	*Accounts Depreciated*	*Undepreciated Balance*	
Autos and trucks	$385,832.26	$260,038.68	$125,793.58	
Buildings	14,399.93	14,107.31	292.62	
Furniture and office machines	67,256.53	46,832.63	20,423.90	
Machines and equipment	240,282.49	160,671.46	79,611.03	
Retail stores	146,586.89	21,021.88	125,565.01	
	854,358.10	502,671.96	351,686.14	
Land			6,100.00	357,786.14
Other assets				
Cash value life insurance		24,387.00		
Notes receivable—Employees			47,897.15	
Goodwill			2,600.00	
Meter deposits			187.50	75,071.65
Total Assets				2,358,753.04

EXHIBIT 8 (*Continued*)

LIABILITIES AND CAPITAL

Current liabilities		$269,898.85	
Accounts payable—Trade		381.02	
Accounts payable—Employees		50,000.00	
Notes payable		31,442.84	
Employees profit sharing trust		15,851.55	
Dividends payable		64,224.75	
Federal income taxes		114,279.04	
State income taxes		7,554.76	
Total Current Liabilities			$553,632.81
Other liabilities			
Advance deposits on wine sales			11,000.00
Total Liabilities			564,632.81
Capital stock issued			
Preferred (19,849 shares—par value $25.00)	496,225.00		
Common (136,500 shares—par value $2.50)	341,250.00		
Common—Class "A" (130,000 shares—par value $0.25)	3,262.50	$840,737.50	
Retained earnings		892,643.48	
Paid-in capital		60,739.25	1,794,120.23
Total Liabilities and Capital			2,358,753.04

Note: The company was contingently liable as endorser on customers' notes at Quincy National Bank in the amount of $138,428.06 and also for notes receivable discounted at the City National Bank in St. Louis, Missouri, in the amount of $23,347.09.

Dividends payable as shown above under Current Liabilities were paid on January 5, 1960

(signed)

JONES, BROWN, AND KING
Certified Public Accountants

Executive Vice-President

Ozark Bowling Industries[*]

I.

Jesse Benton, owner and manager of the Benton Bowling Lanes of Fayetteville, Arkansas, planned to build another bowling business. He was undecided on several subdecisions such as location, financing, leasing, future market, and so forth. Consequently, he sought the advice of a college professor of business administration. Together the two of them came up with the following information.

Background of Benton Has Some Bearing

Jesse Benton wanted to build another bowling alley since he had been in his present bowling alley for the past 13 years. His reasons were varied. He felt that he had excellent experience which gave him confidence in himself in his business. He also wanted "to protect his present business." His lack of parking facilities bothered him. He felt that there was a good possibility that an outsider would overstaff the Fayetteville area with bowling facilities by erecting another bowling alley in town. Such an action, he thought, would jeopardize his present competitive advantage of being the only alley in town. By being in control of two businesses, Jesse thought that he could "protect his present position."

Jesse wanted more income and more security to educate his four children. Within two years, one of his children would be college age. Another would be college age in four years.

In addition, he wanted to continue to prove his managerial ability since he felt quite at home in managing his present bowling alley.

Benton's Qualifications Are Interesting

Thirteen years of bowling experience in being a proprietor was one of Jesse Benton's chief assets. He had nine years of experience as a partner with his brother and four years of experience as a sole owner and manager of his present Benton Bowling Lanes.

Summarized, his business experience was as follows:

1938–43. Arkansas Power and Light Company in Fordyce as a general all-round man (kept books, made repairs, climbed poles, and so on). Quit because of low pay.

1943–45. Ozark Ordnance Works (now Lion Chemical Co.) in El Dorado. Worked in maintenance. Studied electricity on the side. Quit because he didn't like to be "fenced in." Did not like regimentation.

1945 (spring–November, 1945). Worked 6 months in his uncle's bank in Fordyce. Job was a temporary one until he could work for his brother.

1946–47 (August). Worked for his brother in bowling alley in Pine Bluff.

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[*] Prepared by Robert D. Hay, University of Arkansas.

1947 (August–October, 1954). Was one-third partner and actively managed the present Benton Bowling Lanes in Fayetteville.

1954 (October–to present). Managed present business after buying out his brother's two-thirds interest for $20,000.

He forecast two events which later came to pass and which were two reasons for buying out his brother. Jesse foresaw increased student enrollment at the state university, which was located one block from his bowling lanes. He also thought that automatic pin setters would come in about five to eight years. Actually he installed automatic pinsetters in 1956, two years after he purchased his brother's interest. Student enrollment jumped from 3,800 in 1954 to 6,000 in 1960.

Jesse's education consisted of four years at Fordyce High School from 1932 to 1936 and two years at Henderson State Teacher's College from 1936–38. He married during his sophomore year.

His personal characteristics, which Jesse thought were important to any success he might have, were as follows: He worked hard and long when the occasion demanded. Tenacity made him stick to a project until he could prove the outcome to himself. He sought advice from others before making difficult decisions. His physical stature (220 pounds, 6 foot 4 inches), he admitted, was an asset to his business. Except for a facial operation, his health was good.

He said that during the past two years he had developed an ability to meet the public. He was definitely customer conscious in most of his thinking. He stated that he did not "hate" anyone but that he disliked some people more than others.

He tended to be critical in his thinking as opposed to thinking positively. Whenever someone proposed something to him, he was apt to analyze what was wrong rather than what was good. However, he took time to make decisions rather than snap decisions.

He thought his communications ability was adequate. He wrote all of his letters and reports; he made his own signs; and he had little difficulty in speaking.

His wife was in favor of his expansion plans as was his father-in-law (80 years old) who held a first mortgage on his present business. A second mortgage was held by his brother, Jim, from whom he bought the present business. However, Jim released his mortgage in lieu of a personal note signed by Jesse. Both Jim, his former partner in Pine Bluff, and his father-in-law thought Jesse's plan was the best course to follow. His father-in-law was willing, according to Jesse, to release the present mortgage on the business if Jesse were to sign a personal note for the remaining debt of $10,500 (see financial statements).

Management Philosophy of Jesse Benton

Jesse Benton stated that the objective of his proposed Bowling Lanes was to satisfy the needs for more bowling facilities in Fayetteville and

Springdale. This service in turn would protect his present business and offer an increased income to him. His objectives meant to him that customer service was of the first consideration. If he had no customers, he had no business. All other "special" groups concerned with the business he recognized had a mutual relationship with each other. The employees, creditors, suppliers, and community created a dependency which he, as owner-manager, was in a position to balance. No one group had priority except customers, and they came first.

His beliefs about business ethics were that "he would continue to observe normal business ethics dealing fairly with people concerned with the bowling lanes." He also had no views about "scientific management" except that he wished to know more about it.

Decision making in the present and new venture would be handled by Jesse with the help and assistance and opinions of other people. He would make the routine decisions by himself; for the nonroutine decisions, he would seek the advice of Mr. Higgins, his assistant manager, and his wife. Jesse wanted to have control of the new business without being hamstrung by a board of directors. He would seek the counsel and advice of the board for long-range decisions, but would still reserve the decisions to himself. He would prefer to make all the decisions himself, but he also recognized that some authority must be delegated to the operators of both the alleys for internal operations. External affairs would be handled by Jesse. Very little authority would be delegated.

Jesse believed that a business organization must have policies in order to let people know what to expect. Consequently, he expected to have both written and oral policies. At the time, he had very few policies in writing. His intentions were to formulate written policies as situations developed. Once policies were formulated, he would state "reasons why" in the policy statements so that people would understand and accept the policy.

He believed in "new ideas." In fact, he looked for new ideas to improve operations with customer satisfaction in mind. In his trips to various places, he looked for new ways of doing things. He believed, for example, that coin-operated bowling alleys were five to 10 years away. Automation would continue. He believed that any business which dealt with the public had to have the respect of the community and that this respect came from keeping up with changes.

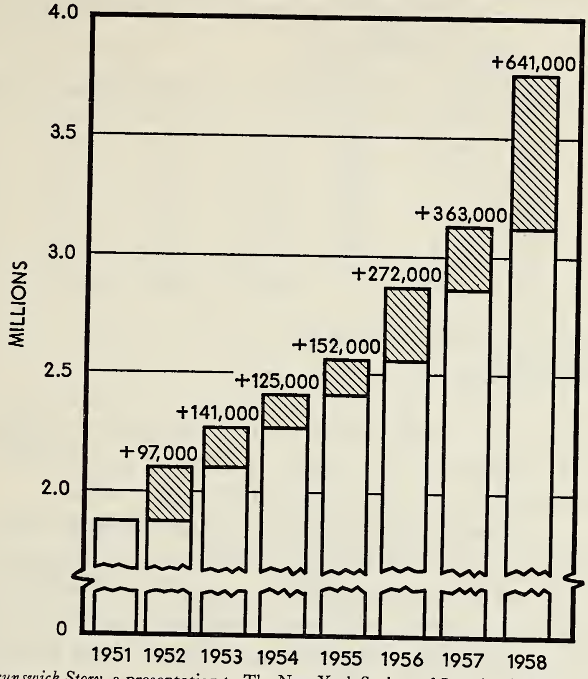
Market Plans for New Expansion

Jesse believed that the future of bowling looked good. Television had added to bowling stature. He also thought that his present marketing area offered a chance for success in his proposed expansion.

Fayetteville and Springdale were his proposed market, with emphasis on Springdale since it has no bowling lanes at present. His potential cus-

EXHIBIT 1

GROWTH OF U.S. REGISTERED BOWLERS, 1951–58



Source: *The Brunswick Story*, a presentation to The New York Society of Security Analysts by B. E. Bensinger, L. H. Swanlund, January 14, 1959.

tomers were anyone between the ages of 10 and 70. Upon inquiring he found the following population statistics:

EXHIBIT 2

POPULATION OF WASHINGTON COUNTY, SPRINGDALE AND FAYETTEVILLE

	1930	*1940*	*1950*	*Latest Year*
Springdale	2,763	3,319	5,835	Estimated 7,328 (1956)
Fayetteville	7,394	8,212	17,071	Actual 18,069 (1957)
Other	29,098	29,583	27,073	...
Total Washington County	39,255	41,114	49,979	Estimated 49,649 (1958)

Source: Population censuses of 1930, 1940, 1950. Estimates were made by Bureau of Business Research, University of Arkansas.

Further investigation showed the age distribution of the population. (See page 152.)

The "usage factor" in the bowling business was difficult to determine. No evidence was available as to how many times a week, for example, a typical customer bowled nor when he bowled. Current experience in the

EXHIBIT 3

AGE DISTRIBUTION OF POPULATION FOR SPRINGDALE AND FAYETTEVILLE

Age in Years	*Springdale*				*Fayetteville*			
	1940		*1950*		*1940**		*1950†*	
	Number	*Percent*	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*
0–14	796	24.0	1,592	27.3	1,738	21.2	3,551	20.8
15–19	336	10.1	442	7.5	777	9.5	1,590	9.3
20–24	281	8.5	466	8.0	906	11.0	3,375	19.8
25–59	1,444	43.5	2,565	44.0	3,854	46.9	6,929	40.6
60–74	373	11.2	608	10.4	741	9.0	1,216	7.1
75—above	89	2.7	161	2.8	196	2.4	410	2.4
Totals	3,319	100.0	5,835	100.0	8,212	100.0	17,071	100.0

* Census did not include students at the University.
† Census did include students.
Source: Censuses of Population.

bowling business indicated that it took from 1,000 to 2,000 people for one alley-bed, depending on several factors. In Fayetteville, at present, there were 18,000 people with 10 bowling alley-beds.

Climate seemed to have an effect on the market. In northern states, for example, bowling was more popular than in the southwestern states. Extreme cold and/or hot spells caused the number of bowling lines to fall.

Jesse stated that there was a direct correlation between population and number of people bowling. He also said that the older retired people did not participate.

Jesse thought sex had some effect on bowling. Women participated. Female participation in Jesse's bowling business he estimated to be about 20 percent of total league play. In open bowling, he estimated that about 35 percent were women. He thought that a lack of leadership among women was the cause for low participation.

Industrial employees made good customers, according to Jesse. Farmers did not. Anyone with a regular salary makes a good potential customer. Retail establishments provided a fair potential. Industry was excellent potential. Institutional participation provided excellent potential for league play, the heart of the bowling market. Church leagues and civic leagues needed to be pushed, according to Jesse.

The more married people, the more dependable the customers were. Jesse said there was a nationwide movement to use television to push family bowling. American Machine and Foundry and Brunswick both used television.

Racial differences in population had no effect on Jesse's business since most people in the area were white.

Purchasing power of the market was estimated. (See Exhibit 4.)

Jesse observed that his customers bought more lower-priced bowling equipment than higher-priced better quality goods. He also estimated that a family income of $4,000 was the best market for his business because

EXHIBIT 4

Income per Capita for Selected Years

Year	*Washington County*	*State of Arkansas*	*United States*
1940	$ 232	$ 256	$ 595
1950	740	802	1,491
1954	972	979	1,770
1955	1,035	1,091	1,866
1956	1,102	1,123	1,961
1957	1,100	1,151	2,027

Source: *Survey of Current Business* and Business Bureau.

bowling, in his opinion, was rather inexpensive in comparison with other recreation. He thought that people in this category spent a great percentage of recreation money on bowling. Bowling was about equal to fishing, according to Jesse.

EXHIBIT 5

Growth in Sports, Total U.S. Participation

Category	*1946*	*1956*	*1966 Estimates*
Boating	20,000,000	28,000,000	40,000,000
Fishing	13,100,000	20,813,000	30,000,000
Bowling	12,500,000	20,050,000	35,000,000
Hunting	9,990,000	11,784,000	20,000,000
Basketball	5,000,000	7,106,000	12,000,000
Softball	4,700,000	6,675,000	10,000,000
Tennis	4,100,000	6,583,000	8,000,000
Golf	4,300,000	5,100,000	10,000,000
Archery	1,700,000	4,600,000	8,000,000
Skiing	1,400,000	2,180,000	5,000,000
Football	1,500,000	1,725,000	4,000,000
Track and field	675,000	580,000	2,000,000
Wrestling	150,000	170,000	1,000,000

Source: *The Brunswick Story*, a presentation to The New York Society of Security Analysts, by B. E. Bensinger and L. H. Swanlund, January 1959.

Direct competition in the area consisted of one bowling establishment in northwest Arkansas. Rogers, located about 20 miles north of Fayetteville, had a 10-alley establishment, started about one year ago. There had been some talk of someone setting up another alley in Fayetteville and one in Springdale. Nothing definite had happened.

Indirect competition in the form of football games, basketball games, fishing, golf, hunting, sunshine, and so on, caused Jesse a great deal of concern. Such competition interfered with his league bowling.

Economic conditions seemed to be favorable for bowling. The long-term trend was upward. Even during the depression, bowling alleys had survived.

Bowling businesses had a seasonal problem. Most bowling occurred during the winter months. Jesse's business was no exception. However, the installation of air conditioning, the advent of television, and more advertising had caused the seasonality to decrease.

Wartime conditions favorably or unfavorably affected the business depending on the location. People had money to spend, and bowling seemed to offer a place to have fun and relaxation.

A real depression would have an unfavorable effect on the business inasmuch as money spent for recreation would probably be the first to be cut back. However, Jesse thought any depression would not hurt the bowling business too much since the last depression saw few bowling alleys go out of business.

Jesse's immediate market goal was to secure 120 teams for league play on Monday through Friday evenings for the new bowling alley. He wanted to get 80 teams out of Springdale and 40 teams out of Fayette-

EXHIBIT 6

TABLE ON GROWTH OF BOWLING INDUSTRY
From 1946 to Present

Date	*Number of Certified Lanes*	**ABC Members*	**WIBC Members*	**AJBC Members*	*Total Bowling Congress Membership*
1946–47	44,513	1,104,400	250,478	8,767	1,363,645
1947–48	46,004	1,258,400	301,064	13,683	1,573,147
1948–49	50,145	1,368,400	362,779	20,319	1,751,498
1949–50	53,243	1,416,800	496,000	24,139	1,936,939
1950–51	56,004	1,430,646	543,000	25,935	1,999,581
1951–52	56,287	1,482,756	583,000	31,606	2,097,363
1952–53	56,928	1,569,537	630,000	38,435	2,237,972
1953–54	58,982	1,651,658	665,000	46,090	2,362,748
1954–55	60,648	1,741,982	706,000	66,526	2,514,508
1955–56	63,210	1,929,065	764,000	93,767	2,786,832
1956–57†	67,967	2,153,012	865,604	131,255	3,149,871
1957–58	76,486	2,604,505	1,005,167	181,218	3,796,890

* Note: ABC = American Bowling Congress.
WIBC = Women's International Bowling Congress.
AJBC = American Junior Bowling Congress.
ABC individual membership was calculated, multiplying the number of teams by 4.4, the officially designated figure of the organization.

† The records for the entire year 1957–58 are incomplete but the figures indicate a continued trend upward of the average number of persons per lane.

Source: Bowling Proprietors' Association of America, June 18, 1958.

EXHIBIT 7

FAYETTEVILLE MEN'S BOWLING ASSOCIATION MEMBERSHIP COMPARISON

Season	*Leagues**	*Teams*	*Individuals*
1955–56	5	54	252
1956–57	6	63	319
1957–58	6	75	339
1958–59	7	81	414

* In addition, there are two women's leagues.

ville. These teams would be in addition to the 96 teams which he planned to keep in Fayetteville.

The detailed actual revenues and number of lines bowled for 1955–56–57 and 1958 are presented. During the 1955–56 season (September through August) the present alley averaged about 25 lines per lane per day. The 1956–57 season yielded a 29-line per lane per day average; the 1957–58 season, a 34-line per lane per day average. The present season should yield about a 37-line average.

Jesse's estimate for the 1959–60 season is presented using a 40-line per lane per day average for the new alley. The first year's estimate of $151,000 gross bowling revenue, he thought, would be accurate because of the additional parking, new alley's opening, and TV advertising campaigns.

EXHIBIT 8

ESTIMATED REVENUE FOR FIRST YEAR OF OPERATION FOR OZARK BOWLING INDUSTRIES

					Total	
1959	*Benton's Lines*	*Benton's (Dollars)*	*Spring Lines*	*Spring (Dollars)*	*Ozark Lines*	*Ozark (Dollars)*
August	9,000	$ 4,200	16,000	$ 8,800	25,000	$ 13,000
September	11,000	5,400	15,000	8,600	26,000	14,000
October	11,000	5,500	14,000	7,500	25,000	13,000
November	11,000	5,500	14,000	7,500	25,000	13,000
December	12,000	5,800	13,000	7,200	25,000	13,000
January	16,000	7,800	18,000	9,200	34,000	17,000
February	15,000	6,400	17,000	8,600	32,000	15,000
March	16,000	7,200	19,000	10,800	35,000	18,000
April	11,000	5,000	14,000	7,000	25,000	12,000
May	7,500	5,000	11,500	6,000	19,000	10,000
June	4,000	2,200	7,000	3,800	11,000	6,000
July	5,000	2,600	7,000	4,400	12,000	7,000
Totals	128,500	$62,600	165,500	$89,400	294,000	$151,000

Location Is Deemed Basic

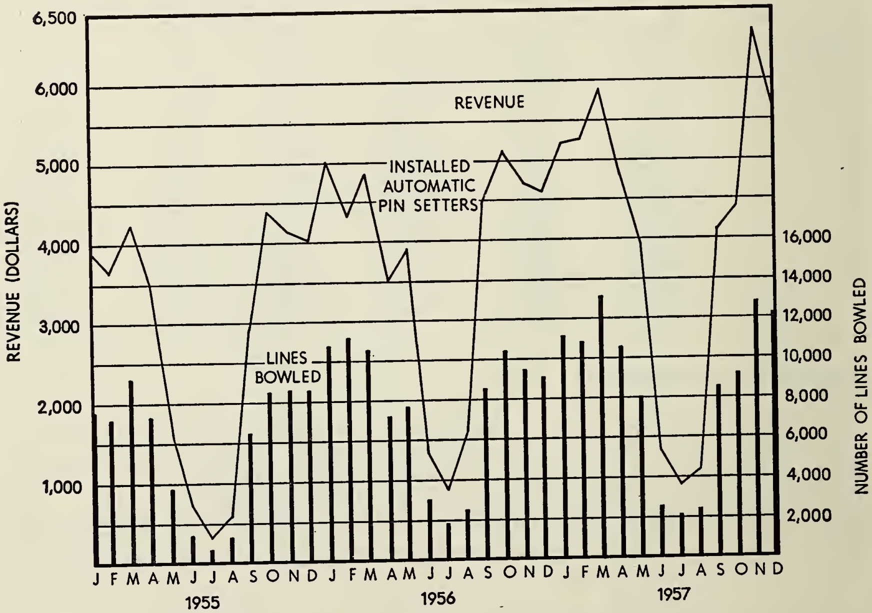
Having arbitrarily selected northwest Arkansas as his market region, Jesse had to decide on the exact location of the new alley. He narrowed his choice down to two places—Fayetteville or Springdale. These two places were the only ones which had enough population to warrant 12 lanes, in his opinion. He made a comparison between the two towns:

Springdale	*Fayetteville*
1. No direct competition in town.	1. Already had 10-lane alley.
2. City population was growing at fast rate.	2. Population growth rate was slower than Springdale.
3. Area between Fayetteville and Springdale will grow.	3. Same.
4. Living conditions were OK in Springdale.	4. Living conditions better in Fayetteville—cleaner city, morally and physically better (he thought).

Springdale (*Continued*)	*Fayetteville* (*Continued*)
5. Personal factors had no bearing.	5. "Home" was in Fayetteville.
6. Per capita income was higher than Fayetteville but more concentrated in fewer hands (Jesse's opinion).	6. Income per capita was smaller but more evenly distributed. (Jesse's opinion).
7. Jesse thought property tax rates were lower in Springdale.	7. Currently paid $200 a year on a $30,000 assessment at 65 mills. His new tax bill would be $360.75 under reassessment program.
8. Thought that Springdale would grow faster industrially than Fayetteville.	8. Fayetteville was also growing industrially.
9. Springdale was available to all residents in northwest Arkansas.	9. So was Fayetteville.
10. Thought that highway location would bring in more tourists than Fayetteville.	10. Tourist trade was fair.

EXHIBIT 9

TOTAL REVENUE (INCLUDING BOWLING AND MISCELLANEOUS) AND TOTAL NUMBER OF LINES BOWLED: 1955–56–57



Source: Benton's Bowling Lanes records.

Jesse finally decided to build the new alley near Springdale. He was of the opinion that some location, near Springdale, between the two cities might attract bowlers from both places. He thought that the Springdale location would be better, though, than one near Fayetteville. So he looked into four specific sites.

One lot was immediately north of the Springdale Country Club. Another was a piece of property, owned by the country club, immediately south of the club. The third was a lot in front of Lake Fayetteville on Highway 71. The fourth was a lot across the highway from the country club. All four were on the highway out of the city limits.

After consulting real estate agents in Springdale, he finally bought a 60-day option on a lot across the street from the Springdale Country Club. Jesse obtained the option for $50 to buy the lot for a total of $7,035, composed of $6,335 ($6,000 for lot and $335 commission) plus common stock of $700 to be issued to the owner.

The lot had good accessibility for parking. Jesse estimated that 190 cars could be parked. (His present alley lacked both parking and loading facilities.) In addition, the lot was fairly level but had some slope which provided drainage to a nearby creek.

He had never made a traffic count on his present location nor did he plan to do so on his proposed location. However, Jesse had information that Fayetteville-Springdale Highway 71 had the second highest traffic count in the state.

The new building was to be placed on the L-shaped lot. The long side of the proposed building was to face the highway. The cost of both land and building was estimated at $75,000.

Jesse planned on buying the building instead of leasing it. However, he was not averse to leasing if the annual rental were not too high. His preference, though, was to have the building contracted by a local builder.

According to Jesse, the Springdale Country Club environment provided a recreational atmosphere for the new location. Jesse planned to build a small fence to hide the small building next to the property. A nearby gully provided drainage in case of rain, but the gully filled up fast when it did rain.

Even though a tavern was next to the property, Jesse was undecided about selling beer in his new alleys. He had originally planned to sell beer, but some of his friends advised him against such a move.

He did not plan on operating a restaurant by himself. Instead he planned on leasing it to someone for about $100 a month.

There was no direct competition in the area. The closest alley was in Fayetteville, 6.5 miles south; another alley was in Rogers, 13 miles north.

Building and Layout Plans

The new building would be designed around the functions of bowling, restaurant, and outer lobby for sale of pop, shoes, candy, pin ball machines, and so on. The special-purpose building, which could be converted to a grocery store, warehouse, or skating rink, would be especially suitable for Jesse's plans. A comparison follows of Jesse's present quarters to the new proposed quarters:

New	*Present*
1. Yearly utility costs proposed: Electricity..............$1,700 Gas.................... 500 Telephone.............. 300 $2,500 Water would be pumped from well.	1. Present yearly utility costs: Electricity and water .....$2,100 Gas.................... 220 $2,230
2. Accessible to auto traffic since location would be Highway 71, and parking facilities would be available.	2. Not accessible to auto parking or loading facilities. Parking in grocery store parking lot, street, or rear of building. Front door only allowed unloading for materials. Everything, including trash, had to be carried through front door.
3. The building would be owned, depreciated at rate of 30 years' life.	3. Currently leased the building at 10 percent of gross bowling revenue with a minimum of $200 monthly. Lease had 5-year option.
4. Internal traffic no problem.	4. Same.
5. Comfort and safety to customers and employees should be supreme; would be ventilated and sound proof.	5. Inadequate ventilation caused customer complaints; excessive noise because of inadequate sound absorption; had no employee or customer accidents.

Building Construction

1. Would be built of steel frame with concrete; estimated cost should be $17,500.	1. Present quarters built of steel and brick made safe and stable building.
2. Masonry walls should cost $2,600.	2. Solid poured concrete walls.
3. Concrete floors with asbestos vinyl tile should cost $5,100.	3. Concrete slab floors, covered with asphalt tile in lobby.
4. Concrete foundation; built-up roof; ceiling of fiberglass.	4. Foundation of concrete; wooden decking and built-up roof on top; ceiling of 4 by 8 sheets of celotex.
5. Restaurant space should cost $5,000 (for lease to someone).	5. Currently had snack bar which was losing money.
6. No posts in alleys.	6. Had 2 rows of posts which interfered with bowling.
7. Septic tank, water well, and parking lot would cost $4,000.	7. Had none.
8. Air conditioning.............$8,000 Wiring..................... 3,000 Painting and doors and so on.... 4,400 Plumbing.................... 4,000 (Cost estimates were bare minimum.) Building would probably cost $75,000 to $80,000.	8. Had limited amount of acceptable appearance and finish. Needed upkeep and maintenance.

Modernization Features

1. Closed front with double solid glass doors . . . no display necessary.	1. Closed front with glass frame double doors.
2. Would be unique building—fit a special purpose.	2. Ordinary building.
3. Fluorescent, with some incandescent lamps.	3. Fluorescent lighting.

Modernization Features (Continued)

4. Air conditioned with 20-ton air conditioner.	4. Air conditioned to some extent by 7½-ton unit.
5. Light green color as basic.	5. Rust color predominated.

Jesse believed that the present alleys needed additional air conditioning, hand driers, better acoustics, and other equipment to keep it modern.

Manpower Requirements for Present and Proposed Alleys

Currently, Jesse did any job in the alley—machine mechanic, "desk" man, pin chaser, clean-up man, or what have you. To help him in the alley, he employed the following people:

Position	*Name of Person*	*Qualifications*	*Labor Expenses*	
			Monthly	*Yearly*
Day "desk" man	Kitty Higgins	Age 64; 8 years in present position	$150.00	$1,800.00
Night "desk" man and maintenance man	Harry Koenig	Age 51; 5 years in present position; retired Navy	$160.00	$1,950.00
Part time "desk" man on weekends	George Brown	Worked in industry in town	$ 37.50	$ 337.50
"Day" pin chaser	Carl Jordan	Age 18; quit high school	85.00	1,040.00
"Night" pin chaser	Bobby Ramey	Age 16; in high school	85.00	1,040.00
Waitress—worked split shift	Leslie Wingate	Housewife; 7 children	160.00	1,300.00
Janitor of lobby—3 hours every morning	Horace Griffin	Age 43; 9 years experience	60.00	720.00
Janitor of alleys—2 hours every week	Carlos Carr	Age 35; 2 years experience	50.00	600.00
2 desk trainees—Tuesday and Thursday evenings	Jesse's two daughters		90.00	1,100.00
1 pin chaser trainee—Friday evening	Jesse's son		8.00	100.00
			$870.50	$9,592.50

In addition, Jesse was considering adding an "outside promotion" man to promote league play.

Personnel plans for new alleys were as follows:

1. Jesse would like to promote the present day "desk" man, Mr. Higgins, to be assistant manager of the new alleys. Higgins would be replaced by university students or a woman in a bowling league. However, Jesse was not sure Higgins would accept the additional responsibility.

2. Mr. Koenig would become the maintenance man for both alleys. His present position would be taken by university students or some man or woman whom Jesse thought acceptable.
3. Jesse would also like to hire a porter in addition to two janitors required.
4. A baby sitting service was also in Jesse's plans.
5. Jesse would be owner-manager of both locations.

Labor expenses of the new lanes would be as follows:

	Monthly	*Yearly*
Assistant manager and promotion man	$ 300	$ 3,600
Two "desk" positions (possibly 3 if alleys remain open 24 hours a day)	400 for both	5,000
Two pin chasers (possibility of making pin chaser emergency repair man. If so, would raise salaries)	160 for both	2,100
Equipment maintenance man	150	1,800
Two janitors	125 for both	1,500
Porter (not sure)	100	1,200
Baby sitter (not sure; considering one for women's league and open bowling)	100	1,200
	$1,335	$16,400
Owner-manager's salary to be distributed to both alleys	833	10,000
Benton's Bowling Lane's wages at present	870	9,600
Total for both alleys	$3,038	$36,000

Jesse stated that he had some difficulty in finding pin chasers because of the seasonality of the business. Other than that position he had little difficulty in finding people. He knew persons in town whom he could rely upon to get good employees. He mentioned that the Employment Security office was of little help since the majority of their applicants made poor employees. University students were not too successful as employees. He found that customers sometimes became good employees as did high school students. Applicants came to him for jobs rather than Jesse "put out the word" that he needed someone. He used the newspaper to secure pin chasers.

Plans for Acquisition of Money to Finance the New Venture

Jesse's financial needs for the new business were as follows:

Long-term assets		
Building (estimates prepared by Jesse and contractor)		
Construction of building and plumbing costs	$60,000*	
Wiring costs	3,000	
Air conditioning and heating	9,000	
Pump and well installation	1,000	
Parking lot pavement	3,000	
		$76,000
Land (original estimate of $5,000 was upped to $7,000 after checking with realtors)	$ 7,000	
Sign to be erected near highway	2,000	
		9,000

* Would vary according to type of structure.

Bowling equipment and supplies		
Twelve lanes	$37,500	
Seats, lockers, and so on	17,900	
Pins	4,800	
Supplies for bowling	300	
Total (estimate received from Brunswick Co.)		60,500
Other equipment (Jesse's estimates)		
Beverage cooler	1,000	
Lounge furniture	500	
Spectator furniture	750	
Public address system	200	
Heating equipment in shop	100	
Communication system	100	
Desk equipment (cash register, and so on)	750	
Manager's office equipment	700	
League secretaries' equipment	400	
		4,500
Total long-term assets needed		$150,000
Short-term assets		
Merchandise inventory	$ 1,000	
Accounts receivable	1,000	
Cash	1,000	
Total		3,000
Total assets needed		$153,000

His immediate cash requirements were estimated as follows:

One-fourth down payment on bowling equipment	$16,500
Freight on equipment	1,500
One-third to one-half down payment on land and building	35,000
Cash for purchase of sign and other equipment	7,000
Working capital	3,000
Total immediate cash requirements	$63,000

At the end of the first year, Jesse thought he would have to pay $19,000 for the second payment on the bowling equipment and building.

The restaurant portion of the new building was to be leased by Jesse for $100 a month to someone who would like to manage the restaurant as his own business. Jesse arrived at the $100 a month rental as follows:

800 square feet (restaurant) should cost about	$4,400
Taxes at $50 for 10 years	500
Insurance at $2 per $100 for 10 years	880
Interest at 6 percent of $4,400 for 10 years	2,640
	$8,420

The total of $8,420 divided by 10 years would be about $850 a year. Thus, $70–$75 would be the cost each month. He then estimated that the rental income should be $100.

Plans for Sources of Financing Were Flexible

Jesse thought he would find sources of capital as follows:

Sale of common stock (voting and nonvoting)	$65,000	
Less commission	2,000	
		$ 63,000
Borrowed from insurance company or Small Business Administration or some private group with first mortgage		47,000
Borrowed from bowling equipment company on conditional sale contract		43,000
		$153,000

His financial plans included combining the assets of his present business with the proposed alley at Springdale. Thus, he would create a new corporation, Ozark Bowling Industries, Incorporated.

The present value of the going concern, Benton Bowling Lanes, was estimated to be $70,000. Jesse made this valuation based on two factors: He would not sell his present business for less than $70,000. Second, he estimated that the profit figures justified a $70,000 valuation, inasmuch as his business earned between 15 percent and 20 percent of gross income. Net income in percentage terms for past three years was as follows:

	*Standard for 1956**	*Actual 1956*	*Actual 1957*	*Actual 1958*
Income	100.0%	100.0%	100.0%	100.0%
Expenses	82.1	84.0†	81.8	81.7
Income before tax and administrative salaries	17.9%	16.0%	18.2%	18.3%

* Source for standard: *1956 Survey of Bowling Proprietors of America of 38 Alleys Having 9 to 14 Lanes;* average figures used.

† Does not include a write-off of abandonment of old manual pin setting equipment. If abandonment loss were included in expenses, the net income percentage would have been 9.3 percent.

The financial structure of the combined alleys would look as follows:

EXHIBIT 10

OZARK BOWLING INDUSTRIES, INC.
Financial Position Proposed
August 31, 1959

ASSETS

Working capital	$ 3,000
New land and building	85,000
New equipment	65,000
Going concern of Benton's	70,000
	$223,000

SOURCES OF ASSETS

Conditional sales contract for new equipment		$ 43,000
Loan from insurance company		47,000
Capital stock		
Conversion of Jesse's business to common voting stock	$70,000	
Sale of common stock	63,000	
Total		133,000
Total sources of assets		$223,000

The present financial position of Benton's Bowling Lanes was prepared by Jesse with the assistance of his public accountant.

EXHIBIT 11

BENTON BOWLING LANES
Financial Position*
April 1, 1959

ASSETS		
Current Assets		
Cash on hand and in banks	$ 3,786.59	
Accounts receivable	750.00	
Spare parts and supplies	200.00	
Total Current Assets		$ 4,736.59
Long-Term Assets (at cost)	$32,268.88	
Bowling balls and rental shoes		
Snack bar and equipment		
Ten fully equipped Brunswick bowling lanes		
Forty-four sets of pins		
Spectator seats		
Ball cleaning and pin trimming machines		
Heating and cooling systems		
Other furniture and fixtures		
Office equipment and furniture		
Automobile		
Tool kit		
Less depreciation combined as of April 1, 1959	13,236.72	
Net Cost to Be Depreciated		19,032.16
Total Assets		$23,768.75
LIABILITIES AND OWNER'S EQUITY		
Current Liabilities		
Accounts payable	$ 2,997.66	
Notes payable—banks	1,758.15	
Total Current Liabilities		$ 4,755.81
Long-Term Liabilities		
Note payable Arkadelphia Savings and Loan	$ 7,420.79	
Note payable to W. R. Benton	5,000.00	
Total Long-Term Liabilities		12,420.79
Total Liabilities		$17,176.60
Jesse P. Benton, Equity		6,592.15
Total Liabilities and Equity		$23,768.75

* Prepared by Jesse Benton with assistance from his public accountant. Statement not certified.

Notes: The equipment and machinery had been acquired from his brother at $20,000 valuation on October 1, 1954. Original cost was approximately $40,000 in 1947. Since 1954, approximately $9,000 of additional equipment had been acquired. As of October, 1954, Jesse's interest in the partnership was approximately $3,000.

Jesse appraised the present business at $55,000. When the new corporation assumed the assets, Jesse would sign personal notes for approximately $12,500 to pay off the first mortgage of $7,420.79 and the other note of $5,000. He planned on creating $15,000 goodwill plus $55,000 valuation of the assets to raise the value of the whole business to $70,000.

Jesse planned to retain control of the new business by owning at least 51 percent of the total voting common stock. His original $70,000 valuation of the present alley would represent 50–55 percent of the total voting stock outstanding. The percentage would vary according to the situation.

He planned on selling about $65,000 of stock (nonvoting common stock plus some voting common stock). The stock would sell for $10 a share to anyone who wanted to invest. Jesse planned to sell stock to present Fayetteville bowlers and to prospective Springdale bowlers. There would be no minimum number of shares to be sold. In fact, Jesse wanted to sell to as many small investors as he could so that bowlers would also "own a share of the business." He felt that people would become better customers if those same people owned common stock. He also realized that he could retain better control if there were a large number of shareowners rather than a small limited number of influential shareowners.

Jesse planned on selling the stock himself with the assistance of a local stock and bond broker who would sell large amounts to a very few buyers. The local broker and lawyer would take $2,000 of stock as their commission. The net of $63,000 would be raised to take care of Jesse's immediate cash requirements (see preceding discussion).

The conditional sales contract he could negotiate from Brunswick Company or AMF, who would be willing to finance the bowling equipment.

The first mortgage loan from the insurance company presented some problems, however. On five occasions, Jesse had been turned down by a prospective lender. The first company was a life insurance firm in Little Rock, whose secretary to the president Jesse knew. After an exchange of letters and phone calls, the company told Jesse that it did not plan on making any additional first mortgage commercial loans during the first half of 1959.

The second company, a local federal savings and loan company, informed Jesse that the company was not prepared to make loans to a commercial establishment unless it were in existence. Private housing loans were their main reason for being.

Two additional life insurance representatives told Jesse that they were not interested in a small alley. Another company, after Jesse had traveled to Tulsa to interview their representative, told Jesse that pending legislation of increased income taxes against insurance companies made them hesitate to lend money on a special-purpose building which Jesse's business required.

Jesse then turned to the Small Business Administration which invited Jesse to visit them and discuss his plans. Also, Jesse's lawyer promised him that he (lawyer) could find a broker who would be willing to lend $48,000 to Jesse's business. A fee of 1½ percent of the $48,000 would be charged for the broker's services.

Jesse also looked into leasing the building. Jesse would be willing to pay $7,200 yearly for a lease with an option to buy after five years. A local contractor suggested that he (contractor) would build the building for $75,000 and lease it to Jesse. Later, the contractor informed Jesse that no money could be found to finance the construction of a special-purpose building.

Financial Policies

Jesse's attitude toward money was one of conservatism.

He did not have much occasion to take cash discounts on his purchases. Consequently, he made no special effort to take them even though he estimated that he lost $50 a year by not taking the cash discounts.

He planned on relinquishing his 100 percent financial interest in order to expand his present business. If he needed to expand in the proposed business, he planned on doing so by plowing back retained earnings plus sale of stock.

Even though he presently was leasing his building, he did not feel safe under the arrangement. He stated that he would much rather own his building and equipment rather than lease. In his new venture, he planned to buy bowling equipment other than pin setters, which he planned to rent.

He sold on a cash basis with some minor selling on credit to leagues who paid a week after bowling. In his new business he was undecided as to whether to sell on credit to bowlers. He currently thought that credit selling was a fringe item which might be used to meet any competition or to promote bowling if and when the number of bowling participants should slacken.

His depreciation policy depended on the availability of cash. He started a rapid depreciation rate because he did not have much funds. Now he admitted that such a policy was hurting his financial position because most of his equipment has about fully depreciated "on the books." Thus, his income taxes would increase because he could not "take depreciation." He regretted his initial decision to depreciate rapidly. In his new business, his policy would be to use a straight line basis of 10 years on equipment and 30 years on the building.

The dividend policy on his new business would be something like this: He would like to hold about 25 percent of the net income for possible expansion, replacement of equipment at higher prices than original cost, and for unexpected events. The remaining 75 percent would be available for dividends at the discretion of the board of directors.

Profit Plans for New Venture

Detailed income and expense statements for the past three years are presented below. The figures were taken from his personal income tax records, prepared by a local public accountant.

Jesse was familiar with breakeven analyses and their values. Although he admitted that he could not figure one out, he did like to know where the business made a profit based on the number of lines bowled, which he checked every day. His estimates of break even are presented for the present business and his proposed new lanes in Springdale.

At Benton Bowling Lanes, he knew that pin setting rental was 10 cents for each line bowled. Pin replacement amounted to about 4–5 percent of bowling revenue. His building rent was 10 percent of gross bowling revenue.

EXHIBIT 12

JESSE P. BENTON
INCOME AND EXPENSES

Income	*1958*	*1957*	*1956*
Bowling	$52,509	$41,028	$34,125
Shoe rentals	2,231	1,859	1,584
Front sales	7,907	4,221	7,110
Miscellaneous	...	...	157
Pinball machines	1,255	1,427	1,570
Snack bar rental	...	766	448
Locker receipts	185	150	135
Total Income	$64,087	$49,451	$45,079
Expenses			
Automobile	$ 421	$ 459	$ 625
Sales tax on rentals	377	...	...
Unemployment taxes	29	...	...
Building rent	5,000	4,309	3,653
Materials and supplies	5,950	5,330	4,711
Front purchases	5,314	2,608	5,013
Pin setter rental	12,634	10,164	5,561
Advertising	695	330	574
Utilities	2,256	2,159	1,698
Dues and subscriptions	640	244	258
Miscellaneous	15	...	...
Legal	...	50	...
Insurance	754	1,010	805
Licenses	500	499	505
Abandonment loss	...	...	3,074
Night watchmen	60	45	60
Miscellaneous labor	17	...	...
Promotion	875	1,186	1,050
Excise tax	26	...	15
Office expense	95	83	68
Interest	1,246	819	941
Personal property tax	195	218	224
Maintenance	293	...	...
Salaries and wages	10,121	6,470	7,956
FICA taxes	200	130	223
Sales taxes	1,793	1,295	935
Depreciation	4,000	3,044	2,894
Total Expenses	$52,372	$40,459	$40,850
Net Income before Taxes	$11,715	$ 8,992	$ 4,229

Yearly expenses, which remained fairly constant regardless of bowling revenue were the following:

Expenses	*Present*	*Proposed New Lanes*
Utilities	$ 2,300	$ 2,500
Automobile	420	. . .
Taxes and licenses	900	1,500
Materials	3,200	4,400
Advertising	700	1,000
Dues and subscriptions	200	. . .
Insurance	900	1,700
Salaries and wages	10,200	16,400
Interest	1,200	5,200
Depreciation, equipment	4,000	6,000
Miscellaneous	500	. . .
Total	$24,520	
Salary of manager		5,000
Promotion expenses		2,000
Depreciation on building		2,300
Total		$48,000

The sales price of each line bowled was 40 cents. The proposed price of the new alleys would be 45 cents. Jesse estimated that 100,000 lines were needed to break even in his present lanes before profit; he estimated 146,000 lines a year in the new lanes.

EXHIBIT 13

BREAKEVEN ANALYSIS OF PRESENT BENTON BOWLING LANES FOR 1958
(NOT INCLUDING OTHER REVENUE)

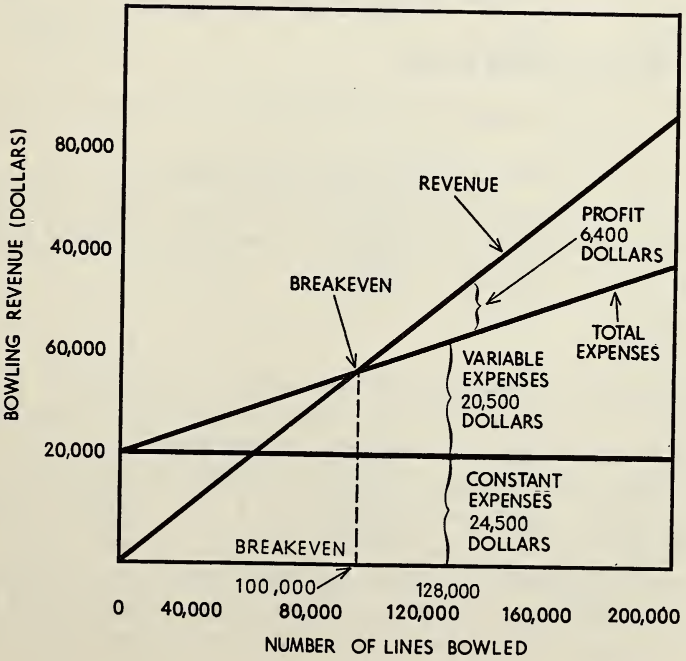
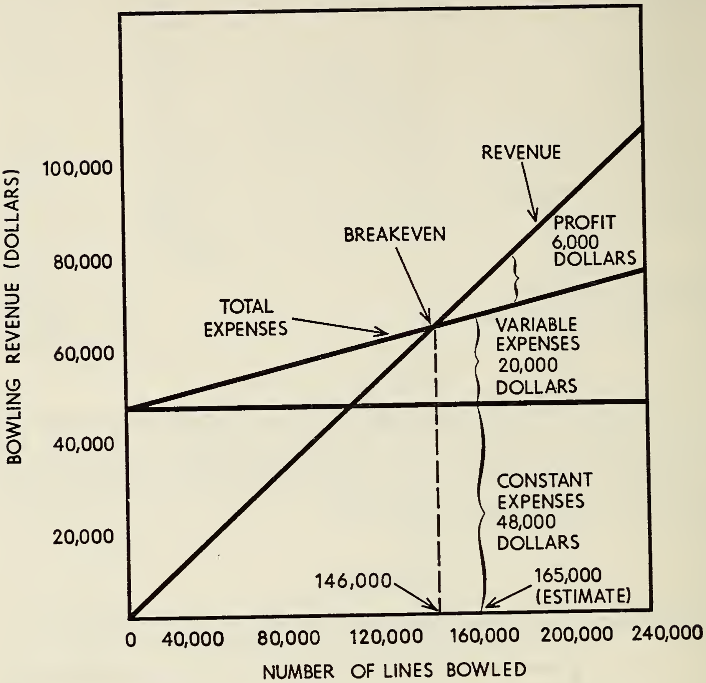


EXHIBIT 14

Proposed Breakeven Analysis on Spring Lanes for 1959
(Bowling Revenue Only)



Projected Cash and Book Profits

Jesse estimated the cash flow and net income for the first year. (See Exhibits 15 and 16.)

According to Jesse, after three years the book value of the owner's equity would have increased $43,000 from $135,000 to $178,000 if no dividends were paid. However, he planned on paying a substantial portion of available cash in the form of dividends.

Organization

Jesse said that his organization was informal and flexible. Jesse was "the boss" to all employees. There was little group contact among the individuals since there were two shifts of people and since the janitors worked early in the morning. Usually two or three employees were present in the alley at any one time. There had been conflict between the night and day desk men and between the desk men and janitors.

Formerly a partnership, the current legal form was a proprietorship. However, Jesse planned on incorporating the new business and the old business into one corporation. He thought about incorporating as a small

EXHIBIT 15

OZARK BOWLING INDUSTRIES
Proposed Income and Expense Statement
First Year's Operation

Income	*Spring Lanes*	*Benton's*
Bowling (40 lines per day per lane at 350 days @ 45 cents)	$75,600	. . .
Bowling (based on last year's remaining stable)	. . .	$52,500
Shoe rentals	2,400	2,200
Machines	600	1,300
Locker rentals	240	180
Front sales	11,000	7,900
Total	$89,840	$64,080
Expenses		
Front purchases	8,000	5,300
Pin setter rentals	16,550	12,850
Salaries and wages	16,400	10,200
Materials and supplies	7,000	5,900
Utilities	2,500	2,300
Sales taxes	1,650	1,800
Advertising and promotion	3,000	700
Taxes on property and other	1,500	900
Insurance	1,700	900
Salary of manager	6,000	4,000
Interest	6,000	. . .
Depreciation on building and equipment	8,333	7,000
Building rent	. . .	5,100
Total Expenses	$78,633	$56,950
Net income before income taxes	$11,207	$ 7,130
Income taxes	3,400	2,100
Net income	$ 7,807	$ 5,030

EXHIBIT 16

OZARK BOWLING INDUSTRIES
Projected Source and Disposition of Cash
After First Three Years

Source of Cash	*1st Year*	*2nd Year*	*3rd Year*
Net income Spring Lanes	$ 7,807	$ 7,970	$ 8,370
Net income Benton Lanes	5,030	5,030	5,030
Total	$12,837	$13,000	$13,400
Plus depreciation not requiring cash outlay	15,333	15,333	15,333
Total Cash	$28,170	$28,333	$28,733
Disposition			
Payment on building principal	3,200	3,200	3,200
Payment on bowling equipment	15,822	10,548	7,032
Total	$19,022	$13,748	$10,232
Net cash available	$ 9,148	$14,585	$17,501

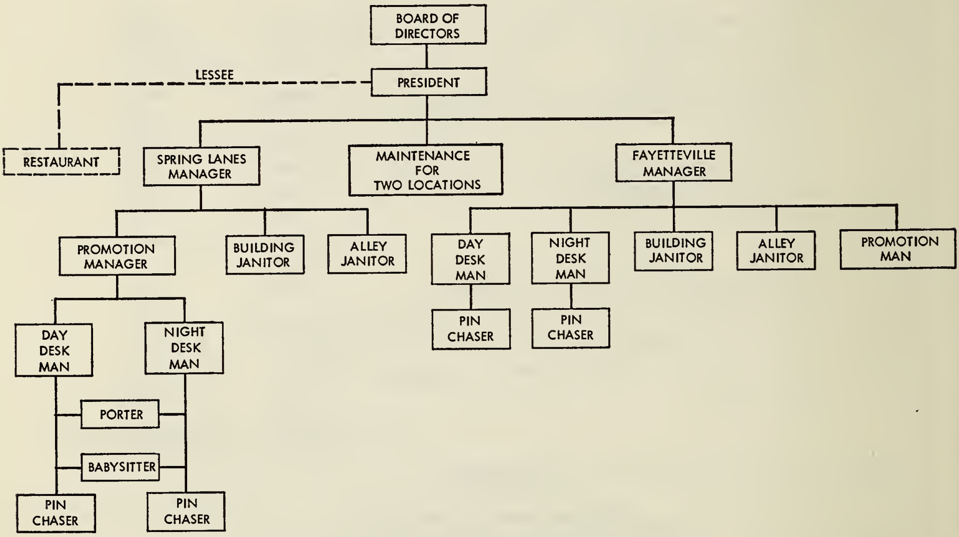
partnership, that is, having a corporate form but paying income tax as a partner. Further investigation, though, resulted in discarding this idea since the new tax law stated that there would have to be 10 or fewer stockholders. After consulting with his lawyer, Jesse planned on obtaining a corporation charter which allowed him to issue 2,000 shares of common stock at $10 a share.

In considering the new organization structure, Jesse had to plan for two separate businesses combined into one overall organization. His plans were as shown in the proposed organization chart. (See Exhibit 17.)

Jesse planned on filling three spots on the chart—the presidency, the manager of Spring Lanes and the manager of Benton's. While he managed in Fayetteville, the promotion manager would be in charge of the Spring Lanes. When he managed in Spring Lanes, there would be no one in charge of Benton's. The restaurant in Spring Lanes he planned to lease to someone.

EXHIBIT 17

Proposed Organization Chart



A typical Monday for Jesse in his current business was spent in this fashion:

10:30 A.M.–1:30 P.M.	Arrived at business from home; checked cash record; made bank deposit; checked reserve supply of money; opened and answered correspondence; went uptown to make contacts and do business.
1–4 P.M.	Went home and rested; sometimes stayed at alley to teach bowling; no particular duties.
4–6 P.M.	Supervised daily shift change; looked over equipment maintenance; ate, sometimes went home; other duties.
6–9 P.M.	Made customer contacts; miscellaneous duties.
9–? P.M.	Went home; on other days stayed at alley till 1 or 2 A.M. working on special projects (currently stayed until midnight working on expansion plans).

On Tuesday he went home at 12 P.M.; Wednesday at 11 P.M.; Thursday at 1 A.M.; Friday 7 P.M.; Saturday and Sunday varied. He spent about 90 hours a week working during the busy season. During slack periods he sometimes did not come to work for a week or so.

He attended the Exchange Club every Wednesday noon, Church Men's Club every third Wednesday evening, and bowled every Thursday evening. One week was like another except during summer months and early fall. Then he had plenty of free time available for fishing and catching up on his maintenance work (resurfacing alleys, painting, installing and repairing equipment, and so on).

He had free time available when other people did not have. Although this time situation interfered with his social and home life, he arranged his hours to suit his convenience. One big disadvantage was that his hours were irregular and came at times when other people relaxed.

He had not attended any yearly trade association meetings, but he did keep up with the trade by reading monthly publications and visiting other alleys.

Policies for Directing Employees

Since manpower was plentiful in northwest Arkansas, Jesse's policy was to get employees when they were needed. Except for maintenance men and snack bar managers, the other employee positions offered no difficulty. And since Jesse was a maintenance man himself, he had few fears about that position.

He had no definite policy on hiring. However, he did lean toward the idea of hiring people at half-time first to see whether the employee was satisfactory.

He always required a personal interview before employee selection because he believed that an employee ought to have enough initiative to come down and talk about the job. He had no tests, no physical examinations, no application blanks, no letters of reference. He based his selection of people on his personal opinion. He said that he hired so seldom that he had no policy.

A five-minute induction procedure was all that he required when he had hired someone.

On-the-job-training was performed for at least two months on practically all jobs before an employee became proficient.

Jesse used loose supervisory practices. He gave an employee a job to do; he let him make mistakes to learn; he allowed the person to "use his own judgement within reason."

Jesse did not have any unionized employees.

On employee morale, Jesse's philosophy was that a person should enjoy his job. If not, it rubbed off on a customer. The person should be happy to have high morale, but Jesse did not think that he himself could make an employee have a high morale. He did try to find out why a person was unhappy if he was.

An employee morale survey was taken at Jesse's request. Most of the employees spoke of it as a "morals test," but they participated gladly. The results indicated a high morale level. The average score was at the seventy-ninth percentile which was substantially higher than the Science Research Associates norm of 50. (The authors of the S. R. A. test point out that any of the 14 catagories tested which deviate more than 10 percentiles from the "company" norm should be significant.) Jesse's employees scored as follows (7 employees took test):

Category	Benton's Score	S.R.A. Norm	Significance
I. Job demands	90	50	Very high
II. Working conditions	98.5	50	Very high
III. Pay	96	50	Very high
IV. Employee benefits	1.5	50	Very low
V. Friendliness and cooperation of fellow employees	87	50	Very good
VI. Supervisory and employee interpersonal relations	79	50	Good
VII. Confidence in management	87	50	Very good
VIII. Technical competence of supervision	97	50	Very good
IX. Effectiveness of administration	97	50	Very high
X. Adequacy of communication	60	50	Not too good
XI. Security of job and work relations	84	81	Average
XII. Status and recognition	75	22	Good
XIII. Identification with company	37	50	Poor
XIV. Opportunity for growth and advancement	22	50	Poor
Total Overall	79	50	High morale

Jesse had no company policy of keeping his employees informed. Seldom was anything put in writing. He seldom told his people where he was going or what he was thinking. If "abnormal" conditions arose, he told employees about them.

Pay for employees was on a straight weekly or monthly rate. There was no pay for overtime.

An informal personnel rating system applied, but he did not tell employees of it.

There was no promotion policy because no promotional opportunities exist.

If a person "did not do his job right," the person was discharged. If a person caused customer ill will, he was fired. Jesse said that the whole organization depended on each employee. If a person did "wrong" all the time, he was discharged in order to preserve order and equity to others. A person was discharged for the following reasons:

1. Improper performance of duties.
2. Drunkenness.
3. Low moral standards.
4. Dishonesty.

There were no layoffs except on the snack bar. If there were no customers, there was no work.

Employees benefits were at a minimum. They were allowed to bowl at reduced rates when alleys were vacant.

Jesse stated that age was no barrier to being hired. He would not hire a Negro to meet the public, but he did hire them for other work. He believed that the general public would not accept a Negro except in minor jobs. He hired an American Indian or Chinese, if qualified, and if he lived in the community. He also hired women for desk jobs but not for pin chaser jobs. Handicapped people would be hired if qualified. He would not hire former criminals to meet the public but would hire them for other jobs.

Jesse currently had few written personnel policies. He considered an employee as an individual human being, and not as a commodity or animal or thing. An employee could reason out things to some degree. He had dignity; he had service to offer in exchange for pay. Jesse had never consciously thought of employees working for recognition, opportunity, "belongingness," or being useful. Upon questioning he admitted, though, that two of his employees did work for recognition and "belongingness."

Planning for Direction of Sales

According to Jesse, bowling had received its latest impetus from television. People liked to bowl because they saw the "champs." In addition, people bowled because of association with others. They enjoyed the recognition of other bowlers as well as the fellowship received. Some people bowled because they wanted to become a "good bowler." Competition spurred some people into bowling, while the desire for relaxation and health was a driving force for others.

Customer policies would be like the ones which Jesse presently followed. (Basic policy was to make the customer feel important.)

1. Liberal returned merchandise policies would be followed, based on the concept of doing things to make the customer happy.
2. Customer complaints would be handled individually. Jesse would listen to complaints, sympathize with them, but would decide each on its merits. Liberality would be the main theme.
3. Merchandise would be guaranteed as far as the manufacturer guarantees it; and in most cases, Jesse would go further in an effort to please the customer.
4. Troublesome customers would be handled individually. Jesse believed that some customers "you're better off without."

5. Customer audits would be used occasionally to find out what the customer thought about the establishment.

Jesse did make a customer survey, the results of which are presented below.

Customer Survey of Benton Bowling Lanes: All League Bowlers
Question: Would you appreciate the following services in Benton Bowling Lanes?

	Men				*Women*			
Items	*Yes*	*No*	*No Answer*	*Total*	*Yes*	*No*	*No Answer*	*Total*
Snack bar	125	5	32	162	39	0	7	46
Restaurant	27	42	93		11	4	31	
Baby sitting service	34	35	92		5	7	33	
Credit selling	22	47	93		5	10	31	
Hand driers	79	17	54		14	3	29	
Tel-E-Score	75	20	67		20	3	23	
Lounge	74	17	71		22	3	21	
Underlane ball return	103	9	50		27	2	17	

Various comments listed from both men and women:

I would like clean sponges and towels.
T.V. for children would be nice.
I've enjoyed bowling because the place is always so clean.
T.V. in lounge, less noise, and general information center.
I like chalk instead of sponge.
Keep the sponge and water.
All good but no inducement to bowl.
A room where you could have a party.
Chalk available instead of sponge.
Would prohibit bowlers from standing on seats and sitting on back of seats.
More balls, especially with extra long span.
Parking—Beer—Parking lot—Need parking area.
Better rest rooms. More shoe brushes.
Too many services and Tel-E-Score only increases operator's costs and cause distraction.
The restaurant would be good business at proposed site, but not at present one.
Tel-E-Score is not necessary but good to have for tournaments and matches.
I think it would be nice to have small room with T.V. for children.
Cocktail lounge and bar. Sell Beer. Sell Beer.
Best to have atmosphere acceptable to middle class family.
A little more room for spectators. More lockers.
No posts between alleys and more clearance at end next to walls.
Better parking lot. Parking space. Parking space.
Would like to have a wider selection of bowling balls.
Posts annoy me when bowling.

Parking space. Parking space. Parking space.
Remove posts.

Question: I bowl for the following reasons:

Item	*162* *Men*	*46* *Women*
Fellowship with my friends	134	40
Recognition among my friends	13	3
Competition	109	14
Exercise	100	35
To get away from home	13	5
I haven't anything else to do	5	2
Health	32	14
Fun—relaxation—I just like to bowl	8	6

Question: Your criticism of present services would be appreciated:

No criticism. Parking space a must if intend to keep present bowlers happy. Present service fine, nice friendly place to bowl. Ladies' rest room could be improved. Pleasant place and have enjoyed it. Not enough time for people not in leagues to bowl. None. None. Okay. I think we're getting nice service at present. No hot chocolate, better ventilation to prevent opening doors in winter [from pregnant woman who wasn't active]. In new bowling center please no posts in lanes area. Cannot complain. Excellent. Good. None. None. None. Very good. None. None. None. None. These lanes are fine, run well, and any member of family can feel at home. Some way of getting rid of smoke. None. A lot of bowlers don't appreciate the service they're getting now. Having to pay for full team when all are not present. Posts and step-off at 10th lane bothers me. Shortage of parking facilities. O.K. except cigarette smokers should use ash trays. Services offered are very good and dependable. Non-enforcement of "No Soft Drinks Beyond Here" Rule, THROW THE BUMS OUT. Services are good compared to several other establishments. Ventilate. Too warm and lots of smoke. None. Very good. None. Good services. None. None except parking. Service O.K. Could use sound absorbent material on ceiling over lanes. Posts obstruct view and game. Not enough lanes. Too much smoke. No particular criticism. Generally good, but price is too high. Wash room facilities not adequate, frequently out of paper towels.

Question: How often do you bowl?

	162 *Men*	*46* *Women*
Daily	1	0
3 times a week	12	0
2 times a week	63	15
Once a week	82	32

Question: Do you bowl in the summertime?

Men: Yes—104 No 39 No Answer—19 Women: Yes—29 No—9 No Answer—8

Comments: Just started bowling. Would bowl more if lanes closer to Springdale. If I'm not having a baby. Would like to be in mixed league. Don't have time. Mixed league bowling desired.

The prices on bowling were set by the owner-manager, based on two factors: cost of investment and what the traffic would bear. In the new establishment, prices would be 45 cents a line, tax included. At Benton the price was 41 cents a line. Price for junior league bowlers was 21 cents. The reason for the differential was that junior league bowlers did not have the money. Jesse also thought that he encouraged juniors to become regular bowlers by reducing the price.

Records Used for Evaluation Purposes

Jesse had a single entry set of books designed by him to help him tell where his business was. His basic record was a daily cash record and a daily count on the number of lines bowled compared with the previous month and previous year. In his new venture, he planned on having a double entry set of books, kept by a public accountant. He might even keep the books himself if he had the time. He used a combination "cash and accrual" system of bookkeeping with no ledgers, no journals, and no basic summary.

Jesse usually had a public accountant prepare his income tax return for him, but he never had prepared a financial position statement because he "didn't need one." He had not definitely decided on an annual audit for his new combination of businesses although he realized that the stockholders might desire one.

The need for records for planning and evaluation purposes depended on how close Jesse wanted to personally keep in touch with the business. However, he recognized the need for better and more records with the new business. He planned on a wholesale change in record keeping because "he kept his assets and liabilities in his head."

He had never made financial statements except during the past three or four months when he had been forced into making several. For the future, he planned on having them made whenever the occasion demanded. He did not think monthly statements would be necessary.

Jesse relied heavily on ratios and comparisons to evaluate progress. For example, he kept close tab on the ratio of machine readings of lines bowled compared to the bowling frames. He knew that 10.6 frames was the average per game. He followed closely the life of pins, which he estimated at 6–7 percent of bowling receipts.

However, he was not familiar with net income divided by investment nor with net income divided by total revenue. Further investigation, however, provided him with some operating ratios and figures received from one of the two major bowling equipment companies.

OPERATING STATEMENTS

	16-Lane	*20-Lane*	*24-Lane*
Net sales	$135,678	$163,225	$197,490
Cost of sales	67,150	90,349	100,850
Gross profit	$ 68,528	$ 78,876	$ 96,640
Operating expenses	44,690	49,386	67,750
	$ 23,838	$ 23,490	$ 28,890
Income from grill	2,000	3,600	4,800
Net income before taxes	$ 25,838	$ 27,090	$ 33,690
Approximate capital investment	$ 90,000	$100,000	$125,000
Return on investment	28.5%	27%	26%

Having gathered the preceding information, both the professor and Jesse are wondering what to do.

II.

Jesse decided to go ahead with his venture. He realized that he would have to raise the money by borrowing and by issuing stock according to his plan. He tried to borrow the necessary cash from various insurance companies, but to no avail. Finally he submitted a loan application to the Small Business Administration in May. He knew that it would take a month to process the loan, and, if the loan were approved, it would take two or three months to raise the money by selling stock to his friends and customers. By the middle of summer he would know whether his plans would start to take shape, for he knew that it would take about two or three months to construct a building and install the necessary equipment for a fall opening, which he thought was the proper time to start a new bowling venture.

In early June the professor friend of Jesse's had casually telephoned the SBA chief to inquire about the status of the loan. The following conversation took place:

PROFESSOR: Is Jesse going to get his loan?

SBA CHIEF: Yes, your plans were excellently presented, and we were ready to grant the loan as of yesterday.

PROFESSOR: You *were* ready??

SBA CHIEF: Yes, we were going to grant the request, but Jesse called us and said to cancel his loan application.

PROFESSOR: What happened? The last time I talked with him he was raring to go!

SBA CHIEF: I don't know the details, but Jesse mentioned something about another man who had broken ground for a building of 12 new lanes in Springdale. Anyway, Jesse told me to cancel his request which I did.

PROFESSOR: Okay. Thank you for the information.

The next time the professor and Jesse saw each other was two days later. A big smile crossed Jesse's face and then followed a look of despair.

"What are you going to do, Jesse?" asked the professor. "What happened?"

"Man, the world just dropped out from under me. Three days ago I received a phone call from my real estate man who informed me that Joe Shafer had just purchased some land in Springdale and had started to build a new 12-lane house. You remember Joe Shafer, don't you? He was the fellow who came in to see me last March to get some information about building a bowling establishment over in Oklahoma," said Jesse.

"You mean that he is going to beat you to the punch in setting up an establishment?" queried the professor.

"Well, I guess so. I don't know what to do. Should I go ahead or not? That guy Shafer! I'll never trust another guy as long as I live," cried Jesse.

"Have you been up to Springdale?" the professor asked.

"Yes, I went up there to see the site. It's in a good location—right on the highway. He's got some bulldozers on the ground, but he hasn't done anything yet," Jesse replied.

"When you heard the news that this Shafer had taken the initiative away from you in Springdale, what was your reaction?" asked the professor.

"All my well-laid plans went to seed," Jesse replied. "When my agent told me the news on the phone, I kept thinking whether I should go ahead. I wondered about whether there would be enough potential bowling interest to support two houses in Springdale. I wondered if I could scrape up enough money in selling stock in the next 2 months to go ahead. I didn't know for sure whether the SBA loan would be approved (but I thought it would be).

"The news was a big surprise to me! That fellow Shafer sure kept his plans a secret. I had no idea that he was planning a new bowling house in Springdale, especially since I had announced in the newspaper that I was going to build a new one in the location right outside of town by the Country Club," continued Jesse.

"Did you have any inkling that Joe Shafer was going to build?" asked the professor.

"No, I did not. He came in to see me about some bowling information. I was very hesitant about giving him any until he said that he was not going to build in Springdale (I told him that I was planning to build there). Shafer told me that he wanted to build some lanes in Oklahoma. I believed him, but now look what happens. What shall I do? Should I go ahead with my plans?"

III.

Despondent and moody all summer, Jesse decided that he could not go ahead with his plans to establish a 12-lane bowling establishment near

Springdale. In the meantime, Joe Shafer went ahead and built 12 new lanes at the outskirts of Springdale.

Business during the summer months was slow as usual, but it started to pick up in August in preparation for the league play to start in September. Joe Shafer's new lanes were not ready for play so Jesse picked up his usual league play starting in September. The good business renewed Jesse's dismal outlook, and at the suggestion of the professor, Jesse decided to plan for establishing some new lanes on the outskirts of Fayetteville.

Joe Shafer's new lanes opened in October and did a landslide business. He had leagues waiting to be formed with no promotion by him. His open bowling took up any slack which existed. In fact, by the end of the first three months of operation, Joe was planning to add some new lanes for next year.

Meanwhile, some of Jesse's friends had talked to him about setting up some new lanes in Fayetteville. Jesse was somewhat skeptical. He figured with 12 lanes in Springdale and 10 in Fayetteville that perhaps there might not be enough demand for another 12 or 16 lanes in Fayetteville. His original benchmark of 1 lane per 1000 people suggested that Fayetteville could stand another 8 or 10 lanes.

In the interim, Jesse installed another two lanes in his establishment to take care of increased demand for bowling. His 12 lanes were all that he could accommodate in his present location. However, when he saw the increased business at Joe Shafer's place, he felt pangs of "I-knew-it-would-happen" and "I-wonder-if-Fayetteville. . . ." and "Oooh, look-at-all-that-business-I-could-have-had."

Jesse also knew that bowling had never been as popular in the South as it had been in the North. Too much competition in the form of fishing, boating, gardening, baseball, and the like cut into the bowling business. In the North, on the other hand, bowling season lasted way into the summer months because of the climate and because of industrial leagues. Therefore, he was reluctant to go into new lanes which might overcrowd the market, but he also wanted to "protect his position" in Fayetteville.

As of November, Jesse was serious about starting some new lanes in Fayetteville. Five of his friends agreed to put up $5,000 each for initial capital stock. Jesse had revised his $70,000 estimate down to $56,300 for his contribution. They were going to borrow the remainder for a new 12-lane establishment from the bowling manufacturers. The five of them had actually looked around for a new location on the north side of town. It became common knowledge that Jesse and his friends were going to build another establishment. In fact a newspaper announcement was made in December about the proposed plans.

In February, at the height of the bowling season, the five were negotiating with Mr. Fox to lease a building, which was to be built on the north side of town on the highway by R. Fox. This lease arrangement would cut down on the money needed to finance the construction of a new business. It would not be necessary to borrow any money since the five prospective stockholders would supply any additional capital needed beyond the original $5,000 which each would contribute.

From February to April, building plans were drawn up, several meetings were held, and five more stockholders wanted to join. The 10 people agreed to form a Corporation (taxed as a partnership) even though they did not know each other too well.

Then one day in April an announcement was published in the local newspaper that another 16-lane bowling establishment was to be built south of town. The venture was to be financed by Joe Shafer and two friends from Texas. The land had been purchased, the same plans were to be used as was done at Springdale, and bulldozers had already been leveling off the dirt on the proposed location when the newspaper announcement was made. However, the three had not cleared the plans with the city building inspection department.

Jesse immediately called a meeting of the 10 people.

IV.

Jesse's group surveyed their stud poker hand and their opponent's. The opponents had an ace and king showing. The ace was the fact that Joe Shafer and his associates had purchased the land and started digging. The king was the fact that they had the money. Jesse's group had only a king showing (they had announced their plans to build). The question was whether Joe Shafer was bluffing or whether he meant to go ahead and beat Jesse's group out of building their lanes. He had done it once before in Springdale.

The threat of Shafer's plan unified the 10 people more than ever. The group decided that they wanted to build their own lanes. They had a king as their hole card in that they also had the money and that their location on the north side of town was superior to the Shafer location on the south side. They also found out that Joe had not received permission from the city building department to build. An alleyway ran through the south location. This alleyway had to be blocked off in order to build the lanes, and the only way it could be done was to get the city council's approval. Approximately one month would elapse before approval could be obtained. So Joe Shafer had a deuce as his hole card.

One week after the group met, the Ozark Bowling Lanes Corporation purchased the land and started building. Three weeks later they found out that Shafer had dropped his plans to build. The group heaved a sigh of relief.

The summer months saw the lanes being built. However, an additional $30,000 had to be raised to take care of blasting, digging, dirt moving, paving, and so forth. Jesse found himself and his group with a $320,000 total investment in assets of which Jesse had contributed $51,300 as the price of his 12 lanes. By the time they had borrowed the necessary money from the bank, Jesse had an owner's equity of approximately 32 percent of the outstanding capital stock. This lack of ownership control bothered Jesse.

In October, the new 16-lane Ozark Bowling Lanes opened for business. The first seven days' business was very shaky. Only 25 lines a day for each lane were bowled, and Jesse's estimates were based on 40 lines a day. In addition, Jesse heard rumblings from the University Faculty League (composed of 16 teams) that they wanted to move their league to the new lanes from the old ones.

The 16-team University Faculty League had bowled at Jesse's old lanes for five years on Friday nights at 6:30 P.M. on his present 12 lanes. Four teams had to bowl the late shift at 8:45. Since most of the teams did not like this extra shift, they looked with envy at the new 16 lanes which would allow them to bowl all at one time. The "younger" set of the faculty wanted to bowl in new lanes while the "oldtimers" preferred the present location.

The faculty league had a meeting to discuss the pros and cons of moving. They noted that an increased price of 15 cents would be charged at the new lanes. They discussed the added parking space and the lack of having an adequate snack bar. Each team captain was then instructed to poll his team members about the proposed change.

Jesse was concerned about the proposal for a number of reasons. First of all, he did not want the faculty league to move to the new lanes because he thought that the move would set a precedent for all the other leagues to follow. Once he lost a league, he would have to spend two years to build another, and most of the bowling revenues from the league would be lost to his old lanes. He knew that it would be easier to form a new league in a new establishment than to build a new league in the old place. Therefore, he asked permission to be at the next meeting of the faculty league.

At the meeting Jesse pleaded with the team captains to stay at the old lanes, giving his reasons—added convenience, lower prices, and the fact that they had committed themselves to bowl at his place when the season started. The team captains, however, reminded him of the customers' prerogative to bowl where they wanted to. Inasmuch as Jesse had a part ownership in both places, they could see very little reason for this not allowing them to move their league to the new house. They could understand his selfish reasons for wanting them to stay, but they wanted more time to think it over. The meeting ended with no decision. In fact, Jesse was dead set against their moving.

A week later a poll was taken of the team members. The results were 39 to move, 36 to stay with some not voting. The faculty league secretary presented the results to Jesse who by now could see the conflict between the customers' needs and desires and the owner's desires. Which was to prevail?

Surfside Marina, Inc.[*]

Introduction

Surfside Marina, Inc., currently conducting business as Pine Harbor, Inc., began operations in 1953 as a small dock primarily for fishermen and small boat operators. It is located on a quiet and beautiful arm of Lake Chickamauga, a TVA reservoir, about two miles from the main channel of the Tennessee River and about 20 miles north of Chattanooga, Tennessee, near a small town by the name of Soddy. Although it is located very far inland in southern Tennessee, Lake Chickamauga is connected by water with the Gulf of Mexico and with the St. Lawrence Seaway. The TVA system of lakes is a rapidly growing resort area and Lake Chickamauga is one of the most rapidly developing lakes in the area. Lake Chickamauga has about 650 miles of shoreline and is about 60 miles long. To the south, it connects with Hales Bar Lake and to the north with Watts Bar Lake. TVA lakes in Tennessee have over 9,000 miles of shoreline. The Tennessee River, which is now a series of TVA reservoirs, flows south from Chattanooga and then north to Paducah, Kentucky, where it empties into the Ohio River, a distance of some 490 miles from Surfside Marina. The reservoirs are connected by locks operated by the Army Corps of Engineers and there is no charge to the boat owner for their use. Commercial and recreational traffic on the Tennessee River has grown rapidly since 1950 and is expected to continue according to TVA authorities.

One of the directors of Surfside Marina, a professor of business administration at a nearby university, commented at a recent board meeting that the business potentialities of the lake seemed to be great. He referred to the great expansion of boating in the last 10 years and pointed out that even greater expansion seemed likely in the future. Reasons given were rising real incomes and more leisure time as productivity increased due to the accelerated technological growth of the economy through automation and new sources of power. Together with a growing population and water resources that cannot be easily increased, it was estimated that established marinas may expect good years ahead. (See Appendix.)

History of the Company

In 1952, Mr. Albert Poling, a retired dairy operator, purchased some 60 acres of land fronting on Lake Chickamauga and proceeded to build a commercial boat dock called "Pine Harbor Boat Dock." A small store was built and slips for about 40 small boats were constructed, most of which were rented shortly after construction. The proprietorship also rented fishing boats and sold a variety of fishing and small boating supplies.

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[*] Prepared by Arthur G. Vieth, University of Chattanooga.

In May, 1956, Mr. Poling died and left the property to his widow, Mrs. Helen Poling. Later that year Mrs. Poling leased the dock to Mr. James Wall, a retired contractor from Illinois, for $200 a month. Mr. Wall was anxious to develop the business and to build additional slips, but he felt that the funds should be provided by the owner of the property. A limited amount of building material was provided and little expansion took place. During the winter of 1957, business fell off rapidly and after much discussion Mr. Wall succeeded in getting the rental reduced to $100. However, seeing no future in the business under existing lease arrangements, Mr. Wall finally sold his interest to Mr. A. D. Smith, Sr., in April, 1958. The new five-year lease arrangement for the 2.7 acres provided for a rental of $200 per month except for the slow months of November, December, January, and February, which called for a reduced rental of $100 per month.

Mr. Smith is the president and general manager of Floorcovering, Inc., a thriving business in Chattanooga which provides full floor services and also builds custom kitchens. He is considered by many to be a highly successful businessman. He operates a nonunion business and feels that an owner of a business should be free to make his own decisions without pressure from other groups. Mr. Smith once fought the union in the courts all the way up to the U.S. Supreme Court and won his case. He has a unique capacity to make friends and it is interesting to note that the attorney representing the union in the case is now Mr. Smith's personal legal council and considered one of his most highly regarded friends.

Mr. Smith, when he purchased the boat dock, remarked, "I took over the boat dock as a hobby. I have been ill, and since I owned a cruiser, I thought it would do me good to relax around the water." About one year later in 1959, Mr. Smith said, "I had no idea when I leased the dock that the business would grow so rapidly and that I would invest so much money in it, especially since I only have a five year lease. It is getting too much for me to handle. Something has to be done."

By 1960, Mr. Smith had invested considerable sums of money in the facilities and inventory of the business. The store had been completely remodeled and doubled in size. A display shed for cruisers and boats, together with rest rooms, had been built and additional slips had been constructed. Contracts were signed with Owens Yacht Co., Larson Boat Co. (both now part of Brunswick Co.), Scott Motor Co., the Volvo motor representative, and two manufacturers of houseboats and outboard rafts. A complete line of marine supplies was added as well as motor and boat repair and refinishing services.

In the fall of 1960, Mr. Smith, after unsuccessfully attempting to purchase the property from Mrs. Poling, decided to sell his interest. He had offered Mrs. Poling $75,000 for the property which was the value placed on it by an appraiser from the TVA, but she wanted $150,000.

Unable to negotiate a satisfactory lease, and unable to purchase the property, Mr. Smith called in a group of interested persons, hoping to sell most of his interest in the business. In the meantime, he had purchased an option on 12 acres of land belonging to Walter Bush. However, no one wished to invest the sum of money required for a lease which would expire in less than four years, and a considerable sum of money would be required to exercise the option and develop the new marina.

Finally, in August, 1960, Mr. Smith decided to incorporate the business as "Pine Harbor, Inc.," to sell stock and develop the new tract of land across from the present site, and to build a complete modern marina and lake resort. He also considered the possibility of the new corporation hiring a general manager who would assume full responsibility of operating the business and thus relieve him of that burden.

Several interested people were asked to purchase organizational stock and to serve on the board of directors. Mr. Smith transferred all the property to the new corporation in exchange for 12,000 shares of stock. An additional 8,500 shares of stock were sold to 23 organizers for five dollars per share. Mr. Smith transferred property costing $88,165 to the company which consisted of (1) a lease of 2.7 acres of land belonging to Mrs. Helen Poling; (2) an option to purchase a 12-acre tract of land on the lake at a price of $45,000. The option cost Mr. Smith $200; (3) intangible assets such as moorage contracts, franchises, and good will; and (4) physical assets which include docks with moorage capacity for 129 boats, inventories of boats and motors (including several large cruisers), boat trailers, store and restaurant fixtures, a house trailer, a small truck, and supplies of groceries, fishing tackle, and marine equipment. In addition, the new corporation assumed $66,165 of indebtedness against the assets.

The board of directors was organized in January, 1961, and decided to exercise the option to purchase the 12 acres and to begin negotiations to purchase an additional 10 acres adjacent to the property, and to plan for a public offering of stock.

Litigation

Mrs. Poling, age 75, learned of the plans for the new marina and immediately took legal measures to block the development. In the zoning hearings before the City of Chattanooga and Hamilton County Planning Commission and the Hamilton County Court, attorneys for Mrs. Poling testified that the new tract of land purchased by the corporation should not be rezoned from rural residential to commercial property. They called attention to the fact that the new marina would be too close to Pine Harbor Boat Dock and that there would be too many boats in the area. A few residents of the area who live across from the site of the new proposed marina also objected. However, the Commission and County Court unanimously approved the petition to rezone in favor of the corporation.

The owner and lessee of Pine Harbor then brought suit in chancery court to void the lease of the property to A. D. Smith and to restrain Mr. Smith and Pine Harbor, Inc., from establishing a competing marina across the embayment. The suit also sought to enjoin the company from using the name, "Pine Harbor," and to obtain damages from Mr. Smith for allowing a portion of the docks to deteriorate and for failure to invest an adequate sum of money in the business to build new facilities.

After two days of hearings, Chancellor Clifford Curry, in June, 1961, declared the lease void and enjoined Pine Harbor, Inc. from using the name Pine Harbor. One observer, who is a director of the company, said after the verdict, "The Chancellor has been used as an instrument to render a great injustice. The docks in general are not in disrepair but are improved. One group of slips was improved greatly by covering it with a permanent roof, even though the lease did not provide for it. The other group of slips are no longer usable, but they were old when they were leased. In addition, the main building was doubled in size and modernized and a boat display building constructed, a new launching ramp built, and a new gasoline pump installed."

Another observer, a customer, not on the board of directors, remarked, "It is ridiculous to say that the boat dock was allowed to deteriorate. It is so much improved over what it was when it was first leased that comparison is impossible."

A reputable lawyer in Chattanooga remarked that Chancellor Clifford Curry, who has an aged and ailing mother, has always been known to give fair and impartial decisions on the basis of the evidence submitted.

After the Chancellor's verdict was rendered, the board of directors of Pine Harbor, Inc., met, discussed the case, and voted to change the name to "Surfside Marina, Inc." The conclusion reached was that it was lamentable that the Chancellor did not have all the facts upon which to base his decision. The board was unanimous in its decision to go ahead with plans for the new marina and to sign a contract with an underwriter for a public issue of common stock to provide funds. It was also decided to appeal the case in order to protect the good name of Mr. A. D. Smith, Sr.

Board of Directors

The board of directors is comprised of 22 persons representing a number of different businesses and professions. Included on the board are individuals who own their own businesses such as textile manufacturing, chemical manufacturing, general contracting, retail sales establishments, and general insurance. Two members of the board have had considerable experience in the restaurant and hotel business. An electrical engineer, a manufacturer's representative for hardware and building materials, a university professor who specializes in finance, and a member of the Tennessee Bar Association are also on the Board. Nearly every director is a boating enthusiast and takes a personal interest in the affairs of the company. Also, each director has invested in the organizational stock of the company.

Management and Personnel

The first manager of Pine Harbor Boat Dock under Mr. A. D. Smith's lease was his grandson, Jimmy Brock, age 21 and just returned from service in the armed forces. He assumed management of the dock in April, 1958, and continued in that capacity, under the close supervision of A. D. Smith, until September, 1958. By that time the business had grown considerably and Mr. Smith felt that a mature person with more boat sales experience should be added to the management. Mr. Bill Thomas, about 35, a sales representative for Owens Yacht Co., who had been calling on Pine Harbor, was hired as co-manager. Mr. Thomas continued in his position until 1960 when Mr. Smith decided that he was not suitable for the business, and Bill Thomas was replaced by Mr. Terrel Brown who managed the business, with the assistance of Jimmy Brock, until shortly after the company was incorporated in 1960.

During the winter of 1960, Mr. James Stair, of Knoxville, Tennessee, age about 55, a member of the board of directors and a manufacturer's representative of hardware and building materials, was hired as full-time general manager of the new corporation. He assumed his position early in 1961.

In the meantime, Mr. Joseph Brock, son-in-law of Mr. Smith and the father of Jimmy Brock, was transferred from Floorcoverings, Inc., where he had been employed as a salesman for several years, to Pine Harbor, Inc., to manage the business until Mr. Stair arrived. It was expected that Joseph Brock would continue as store manager and bookkeeper and that Jimmy Brock would also remain to help with sales of boats and motors and dock service to customers.

Mr. Stair, the new General Manager, came to the company without any boat or marine experience at all. However, he was eager to learn and after a few months he had gained considerable knowledge of the business. Mr. Stair pursued a cautious policy in regard to trade-ins of used boats and motors and was generally regarded as serious-minded and rather short and frank in conversation with employees and customers.

Several weeks after Mr. Stair assumed the management of the company, Jimmy Brock resigned. He stated that he could not agree with the policies of the new manager and that a person with marine experience should be in charge. In July, 1961, Joseph Brock also resigned and with his son, Jimmy, purchased the Dayton Boat Dock, about 20 miles upstream from Pine Harbor.

A young couple, Leon and Judy Young, from Gadsden, Alabama, were hired to replace Jimmy and Joe Brock. Mrs. Young's responsibilities were to serve customers in the store, keep the books, and act as secretary to Mr. Stair. Mr. Young was hired to perform assigned duties around the dock and to service boats.

In addition to Mr. Stair and Mr. and Mrs. Young, six other persons were employed by the company in August, 1961. Buddy Malone, about 26, an expert on Scott motors and also efficient on all outboard motors, served as chief mechanic and repairman. Walter Eberhardt, about 25, a former employee of a marine supply company and also experienced in marina operations, worked on the docks, helped in motor repairs, and assisted in the store when necessary. Willard Upchurch, fully employed elsewhere and 30 years of age, worked half-time in the mornings as mechanic, boat repairman, electrician, and dock maintenance man. Robert Horne, a young man in his early twenties, and Herbert Jones served as needed to service boats and help maintain the premises. Mrs. Ann Mason worked in the kitchen where sandwiches and short-orders were served. She only worked in the summer months since she was employed as a cook in a local school during the school year.

Present Operations

In August, 1961, Surfside Marina was continuing its operations at the leased site under the name of Pine Harbor, Inc. It was expected that the name "Pine Harbor" would be continued in use until the company moved to the new site. The company operates a snack bar, a store handling fishing and boating supplies and equipment, a boat and motor repair shop, boat and motor sales, and docks with capacity to handle 110 boats.

The marina business is extremely seasonal and since the new corporation under present management has not operated through a full summer season, a meaningful financial statement of operations is not available. However, the prospectus for the new stock offering contains the following information:

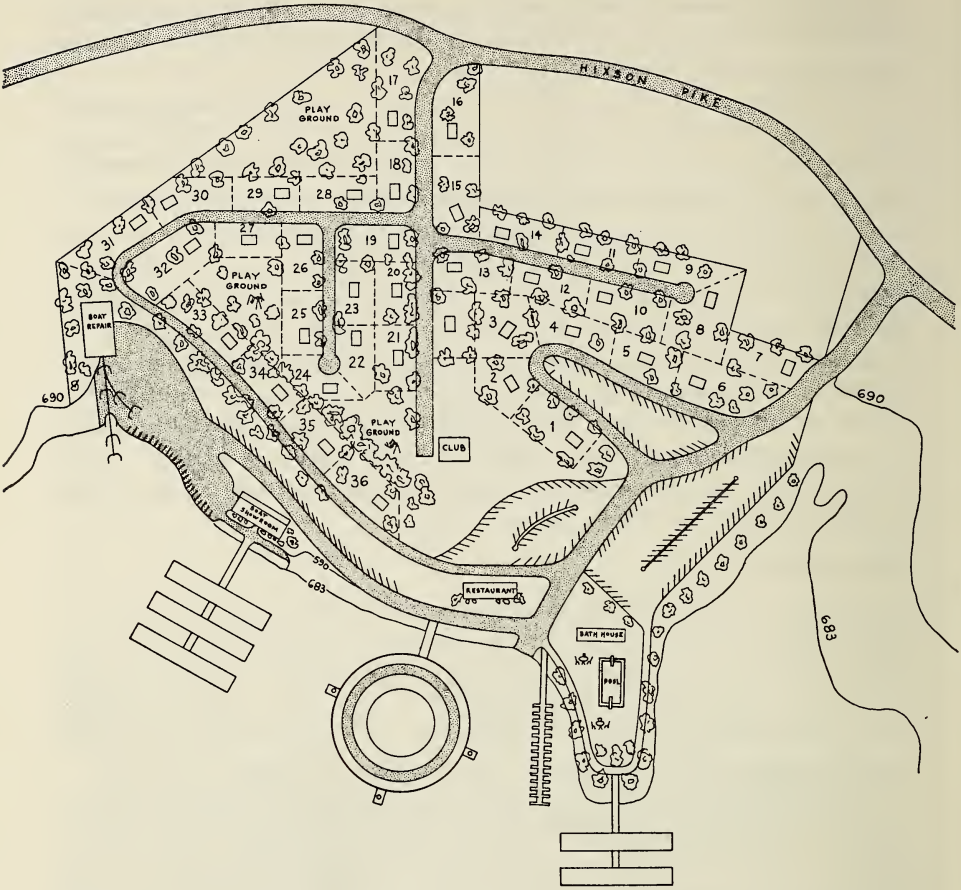
> On the basis of the results of the operation of its predecessor and on the basis of its anticipated expenses, the Company would expect at its present site, with the existing facilities, to receive an annual gross income of approximately $40,000, with annual gross expenses of approximately $38,000, leaving net proceeds of approximately $2,000. As heretofore indicated, the Company's rights to the use of this site are in litigation. . . . Regardless of the outcome of that litigation, the Company does not plan to continue operations at this site after this year. In view of the change in the nature and site of the Company's operations as discussed below, the results and experience of the Company to date do not provide any sound basis for predicting the results of the Company's operations at its new site.

Plans for New Marina

As mentioned earlier, the company purchased a beautiful 12-acre tract on Chickamauga Lake and has entered into negotiations to purchase an

EXHIBIT 1

Layout for the Proposed Surfside Marina



additional 10 acres of adjoining land with considerable lake frontage.

The company is planning to develop a complete marina to include the following:

1. One circular floating dock with a capacity of 108 boats.
2. A display and sales building for boats, motors, and boating and fishing supplies and equipment.
3. Complete boat and motor repair and refinishing facilities including a marine railway to handle cruisers.
4. A modern restaurant.
5. Thirty cottages for vacationers and weekend guests.
6. Access roads and parking areas.
7. Adequate water and sewage facilities.

Total dockage capacity when the new marina is completed will amount to approximately 220 boats. The company will operate all of its facilities except the restaurant which it plans to lease to an experienced restaurant operator. The longer range plans include a swimming pool, bath house, and expanded recreational facilities as funds become available. (See Exhibit 1 for artist's conception of the proposed new marina.)

It is planned that all construction be of aluminum, both interior and exterior, incombustible with maintenance-free color, termite and vermin proof, and fully insulated. Alco Company of Chattanooga and Panelfab Southeast, Inc., of Montgomery, Alabama, have tentatively been engaged to construct the buildings.

Finance

In order to acquire funds for the construction of the new marina an underwriting agreement was entered into with Branum Investment Company, Inc., investment bankers of Nashville, Tennessee. Under the agreement, Branum Investment Company will undertake to sell 60,000 shares of $1.00 par value stock at $5.00 per share on a best effort basis for an underwriting commission of 15 percent. The net proceeds accruing to the company will amount to $255,000 assuming all shares of stock are sold. All proceeds from the sale of stock will be held in escrow at American National Bank and Trust Company, Chattanooga, Tennessee, until $160,000 has been accumulated. If $160,000 of stock has not been sold within one year from date of issue, all monies collected from the public offering will be returned to subscribers. If $160,000 or more of stock has been sold within one year, the funds will be removed from escrow and made available to the company.

The company has entered into an agreement to acquire additional funds through Panelfab Southeast, Inc. The latter company has agreed to secure for Surfside Marina a long-term loan in an amount up to $300,000 at a rate of interest not to exceed 6 percent. The actual amount of the loan will match the funds from the sale of stock, but is contingent upon release of the funds from escrow.

According to the prospectus of Surfside Marina, the funds will be used as follows:

1. Acquisition of contiguous tract of land	$ 12,500
2. Roads and parking areas	22,500
3. Water and sewage facilities	25,000
4. Boat repair building and equipment	25,000
5. Floating circular dock	90,000
6. Retire existing first mortgage on land	30,000
7. Restaurant building	49,227
8. Boat and motor display and sales building	64,119
9. Sixteen cottages of about 624 square feet each	115,102
10. Twelve cottages of about 421 square feet each	54,995
11. Two cottage units of about 684 square feet each	25,945
Total	$514,388

Of the total funds acquired from the sale of stock and the long-term loan, at least $20,000 will be reserved for working capital purposes. The financial position of the corporation as of April 30, 1961, is revealed in Exhibits 2–4.

EXHIBIT 2

Pine Harbor, Inc.
Soddy, Tennessee
Balance Sheet
April 30, 1961

Assets

Current assets		
Cash on hand and in bank		$ 3,896.28
Notes receivable—Trade		138.35
Accounts receivable—Trade		5,171.56
Inventories:		
Boats and motors*	$74,946.03	
Parts and supplies*	5,432.46	
		80,378.49
Prepaid expenses		1,895.30
Total Current Assets		91,479.98
Fixed assets—Schedule 1		
Land	36,014.00	
Boat docks	21,080.95	
Buildings	11,727.03	
Fixtures and equipment	8,858.44	
Leasehold improvements	2,511.66	
	80,192.08	
Less: Reserve for depreciation—Schedule 1	2,118.58	
Total Fixed Assets		78,073.50
Deferred charges		
Organization expense†	5,694.12	
Deposit with vendor	400.00	
Total Deferred Charges		6,094.12
Total Assets		$175,647.60

Liabilities and Capital

Current liabilities		
Notes payable—Banks‡	$71,853.67	
Notes payable—Stockholders	5,608.36	
Mortgage notes payable—Current portion§	3,000.00	
Accounts payable—Trade	17,387.15	
Accrued taxes	1,744.52	
Accrued interest	823.56	
Total Current Liabilities		$100,417.26
Long-term debt		
Mortgage payable§		27,000.00
Total Liabilities		$127,417.26
Capital and surplus		
Capital stock authorized—100,000 shares common stock, no par value		
Issued and outstanding—20,100 shares:		
12,000 shares @ $1.83⅓ per share	22,000.00	
8,100 shares @ $5.00 per share	40,500.00	
	62,500.00	
Surplus—Balance at debit	(14,269.66)	
		48,230.34
Total Liabilities and Capital		$175,647.60

EXHIBIT 2 (*Continued*)

STATEMENT OF SURPLUS

AT APRIL 30, 1961

Balance at credit, November 7, 1960	. . .
Net loss from Exhibit 4	14,269.66
Balance at debit, April 30, 1961	$(14,269.66)

* New boats and motors are valued at cost plus freight. Boats and motors received as trade-ins are valued at market giving consideration to size, make, age, and condition. Repair parts are valued at cost less 35 percent and supplies are listed at cost. Included in inventories is a house boat which according to the books cost $5,836.87 to construct. Its value on the corporation books is $8,750.00. Mr. A. D. Smith, Sr., stated no labor was included in this cost.

Inventories of $69,735.53 are pledged to secure notes payable of $56,600.11.

† Organization expense to be written off over 60 months.

‡ Notes payable secured by inventories (Note 1)	$56,600.11
Notes payable secured by house trailer—Schedule 1 (Note 2)	1,354.05
Notes payable personally secured by A. D. Smith, Sr., principal stockholder	13,899.51
Total	$71,853.67

§ Mortgage notes payable—secured by deed of trust to land and buildings costing $45,000.00. Notes mature at $3,000.00 each year for 10 years beginning November, 1961. Interest at 6 percent.

Note: The corporation is contingently liable for $15,223.84 on endorsements of customers' notes.

EXHIBIT 3

PINE HARBOR, INC.

Soddy, Tennessee

Statement of Operations

From November 7, 1960 to April 30, 1961

Sales		$ 36,850.02
Cost of sales		
Beginning inventory (Cost or market, whichever is lower)	$ 49,170.15	
Purchases	55,813.06	
Freight	699.18	
	105,682.39	
Less: Ending inventory (Cost or market, whichever is lower)	80,378.49	
Cost of sales		25,303.90
Gross profit		11,546.12
Expenses		
Salaries and wages	12,221.49	
Rent, heat, light, telephone	1,922.32	
Insurance	1,448.77	
Advertising	1,288.96	
Audit fees	950.00	
Depreciation	2,118.58	
Payroll taxes	828.17	
Licenses and taxes	619.35	
Supplies	698.94	
Repairs	695.06	
Miscellaneous expenses	946.71	
Total expenses		23,738.35
Operating loss		(12,192.23)
Other expense		
Interest on mortgage and notes		2,077.43
Net loss before income taxes		(14,269.66)
Provision for income taxes		. . .
Net loss for period to Exhibit 3		$(14,269.66)

EXHIBIT 4

Pine Harbor, Inc.

Soddy, Tennessee

Property, Plant, and Equipment*

April 30, 1961

Classification	*Balance 11–7–60*	*Additions at Cost*	*Retirements or Sales*	*Other Charges*	*Balance 4–30–61*
Land†	$35,000.00				$35,000.00
Land	100.00	$ 914.00			1,014.00
Docks	17,100.00	3,980.95			21,080.95
Buildings†	10,000.00	1,727.03			11,727.03
Fixtures and equipment	5,343.50	614.94			5,958.44
House trailer‡	2,900.00				2,900.00
Leasehold improvements	2,511.66	...			2,511.66
	$72,955.16	$7,236.92			$80,192.08

* Land, Buildings and all additions valued at actual cost. Leasehold improvements recorded at actual cost less accumulated depreciation. Values of all other fixed assets determined by A. D. Smith, Sr., and Harry Warden.

† Land and Buildings in the amount of $45,000.00 held under Deed of Trust as Security for Mortgage of $30,000.00.

‡ Pledged to secure notes payable of $1,354.05.

Reserves for Depreciation—Property, Plant, and Equipment*

		Additions			
Description	*Balance 11–7–60*	*Charged to Profit and Loss*	*Charged to Other Accounts*	*Deductions*	*Balance 4–30–61*
Land	...				...
Docks	...	$ 855.00			$ 855.00
Buildings	...	250.00			250.00
Fixtures and equipment	...	578.71			578.71
House trailer	...	145.02			145.02
Leasehold improvements	...	289.85			289.85
	$	$2,118.58			$2,118.58

* All depreciation figured on straight line method.

Competition

As of August, 1961, there were nine marinas operating on Chickamauga Lake. Five of the marinas are relatively close to the dam and compete somewhat vigorously with each other. The large number of boats concentrated at the south end of the lake also results in considerable traffic and water turbulance.

The officers of Surfside Marina believe its location to be ideal, with clear blue water provided by Soddy Creek and less boat traffic since it is off the main channel of the Tennessee River. Yet, the business is close enough to Chattanooga to make it easily accessible. Also, it is located only two miles from U.S. Highway 27, and therefore it is hoped that considerable tourist trade will be attracted.

Looking Ahead

On August 7, 1961, a special meeting of the stockholders of Surfside Marina was held at Floorcoverings, Inc., in Chattanooga. The purpose of the meeting was twofold: (1) to pass a resolution to permit the officers of the company to borrow up to $30,000, and (2) to discuss the status of the forthcoming stock issue.

Mr. Stacy Branum of Branum Investment Co. reported that the Securities and Exchange Commission would probably release the issue on August 9, that the offering circulars would be ready the next day and that the securities salesmen would be ready to begin marketing the issue on the fourteenth. He also reported that he had no difficulty obtaining experienced and highly qualified salesmen and that enthusiasm for the issue was unusually high. He also indicated that he had inquiries from other brokers.

The question of paying the securities salesmen was brought up. Since all funds from the sale of the first $160,000 of the stock must be placed in escrow, it was necessary to have up to $24,000 available in order to pay the 15 percent commission on each week's sales. Mr. Harry Warden, secretary of Surfside Marina and an employee of Floorcoverings, Inc., reported that he had contacted a local bank and was told that the loan of $24,000, as needed each week, would be made if several of the directors would endorse the note so that they would be individually and severally liable.

Since the company's cash position was tight, it was felt that a loan was imperative. Some stockholders suggested contacting other banks for the loan and others suggested that each endorser of the note assume the same fraction of liability as represented by his pro rata share of organizational stock outstanding. It was decided to contact the bank again to review the situation.

APPENDIX

THE PLEASURE BOATING INDUSTRY IN TENNESSEE

by Edward G. Cornelius
Tennessee Polytechnic Institute, Cookeville, Tennessee

The major objective of the research which is summarized on the following pages was to determine the future possibilities for businessmen to manufacture and market marina goods and to provide services for pleasure boaters in Tennessee. The study itself is divided into four parts:

Part I deals with the resources of Tennessee that favor pleasure boating.

Part II is concerned with the development of the pleasure boating industry in the State and a comparison of its rate of growth with that of the Nation as a whole.

Part III presents an analysis of the factors favoring continued growth of the pleasure boating industry in Tennessee.

Part IV is an estimate of the future growth of the industry in the State and Nation.

Pleasure boating has become America's number one outdoor sport for family participation, according to the report. The large industry resulting from this development has grown very rapidly in recent years. Nearly $2½ billion was spent at retail in the United States for marine goods, accessories, and services in 1959, which is about 3½ times the amount that was spent annually a decade ago. In Tennessee, the pleasure boating industry has experienced a growth rate about twice that of the industry nationally.

Natural and Manmade Resources

Tennessee has the natural and manmade resources necessary and desirable for pleasure boating. Support for this statement is found in the fact that the State has already experienced a large increase in this type of recreational activity. The climate, location, and other resources of Tennessee combine to promote a tremendous potential for the pleasure boating industry.

Central location gives a natural advantage in this connection to Tennessee. Tennessee is located halfway between the Great Lakes and the Gulf of Mexico. Half of the Nation's population lives within 500 miles of the State's borders. Its transportation facilities—particularly its highway system over which 97 per cent of its out-of-state tourists arrive—make the recreational areas easily accessible. In addition to its highway, rail, and air facilities, Tennessee has a system of interconnected waterways which promises to become more and more important to the development of the pleasure boating industry in the future.

The relatively mild climate of Tennessee is conducive to outdoor recreation during a larger part of the year than in many other sections of the country. Sunshine prevails about 60 per cent of the possible time, and windstorms are infrequent. Average temperature for the State is 58 degrees. Tennessee's climate permits recreation-minded people to engage in boating activities over a longer season than is possible in most states.

Supplementing its favorable location and climate, Tennessee has many resources which are attractive to people interested in various types of recreation. Differences in land formation, elevation, temperature, and rainfall produce a great variety of plant and animal wildlife and scenery. Sportsmen find many types of game and fish available in the State. These people and those who make up the sightseeing groups also engage in pleasure boating or are potential users of the industry's products and services.

In addition to its natural resources, Tennessee has manmade advantages for the pleasure boating industry. The "Great Lakes of the South," which resulted from the construction of Tennessee Valley Authority dams on the Tennessee River, attract millions of people each year. These calm and well-sheltered lakes and those developed by the (U.S. Army) Corps of Engineers on the Cumberland River are excellent for the operation of pleasure boats. The construction of these large manmade lakes has been a vital factor in the growth of pleasure boating in the State.

Industry Development

Part II of the full report presents the findings of both primary and secondary research regarding the development of the pleasure boating industry in Tennessee for the purpose of comparing it with that of the Nation. Seventy-five boat manufacturers, dealers, and dock operators and 105 boat owners provided the answers to questions about the business, methods of operation, and their opinions about the potential of pleasure boating in the State. The information obtained from interviews, along with the research from secondary sources, according to the report, suggests an accelerated growth rate of pleasure boating in the State.

There are at least 450 lakes with about 9,350 miles of shoreline and 441,500 acres of water surface in Tennessee. The 17 TVA and the 4 Corps of Engineers lakes account for about 88 per cent of the total lake acreage. (A new Corps of Engineers lake was being formed at the time of the survey, and four others had been authorized in the State.) These lakes provide most of the manmade water resources in the State. An estimated 44,000 other lakes, including farm ponds and small private and publicly-owned lakes, add to this water resource.

Data as to the total amount of recreational facilities available to pleasure boaters at lakes in the State are unavailable. In 1959, there were 254 boat docks and 488 public access points on the TVA and Corps of Engineers lakes alone. The estimated value of recreational facilities at these lakes was $41,233,620. Also in 1959, person-day visits were estimated at 25,397,108, of which about 29 per cent, or more than 7¼ million were for pleasure boating.

Favorable Growth Factors

The population of Tennessee is expected to grow more rapidly in the future. High birth rates have previously been offset by a great outflow of young people searching for jobs in more industrialized states. Industrialization is now progressing more rapidly in Tennessee than in the Nation, which means improved job opportunities and an increase in the rate of population growth. This indicates the possibility of a more rapid increase in boating in the future.

Further industrialization is also expected to result in rising per capita income as Tennessee workers leave relatively low-paying farm employment for industrial jobs. It has been estimated that a 1 per cent increase in personal disposable income generally leads to about 3 per cent greater spending for pleasure boats. It should be noted that the rate of gain in income in Tennessee exceeds the national average.

Leisure time is expected to increase with industrialization. With more time free from work, people turn to greater participation in outdoor sports, and boaters find it possible to enjoy the lakes more frequently as the workweek is shortened. It seems reasonable to suppose that the rate of increase in leisure time in Tennessee will exceed that in the Nation as a whole, due to the State's relatively rapid rate of industrial progress.

Vacation travel throughout the Nation has increased tremendously. Industrialization has to some extent been responsible for greater urbanization. Higher incomes, increased leisure time, more paid vacations, and a widespread desire to escape crowded cities for outdoor recreation help explain the large amount of vacation travel. As more people over the Nation travel greater distances on longer vacations, the extent of vacation travel in Tennessee is likely to increase. The rates of increase in industrialization, population, per capita income, and leisure time in the State as compared with the national rates indicate that vacation travel will increase more rapidly in Tennessee. Moreover, vacationers in the State tend to devote a relatively large proportion of their vacations to outdoor recreation, including boating.

Estimated Growth

These facts suggest an accelerated future growth rate of pleasure boating in Tennessee. There should be substantial business opportunities in manufacturing and marketing marine goods and accessories and rendering services for pleasure boaters. On the basis of recent business experience in the State, it is estimated that sales and spending for these items will increase as follows between 1959 and 1965:

a) 75 per cent greater sales of new outboard boats.
b) 58 per cent greater sales of new outboard motors.
c) 93 per cent greater sales of new boat trailers.
d) 105 per cent greater spending at retail for new outboard boats and motors and boat trailers.
e) 139 per cent greater spending at retail for accessories and services.
f) 133 per cent greater total spending at retail for new outboard boats and motors, boat trailers, accessories, and services.

With the increase in total retail spending for these goods between 1959 and 1965 at 133 per cent, the average annual rate of increase for the 6 years would be just above 22 per cent. This is about 83 per cent greater than the expected national rate of gain. It should be noted that this estimate is based upon a continuation of the past growth rate and makes no allowance for the fact that a greater future growth rate is possible.

It is estimated that the State's share of the national market in dollar volume in 1965 will be about 2.6 per cent of new outboard boat sales, 2.8 per cent of new outboard motor sales, 3.1 per cent of new boat trailer sales, and nearly 2.8 per cent of accessory and service sales. Potential business opportunities in the pleasure boating industry in Tennessee are great. Whether this potential is realized depends upon many factors. The nature of some of these opportunities is indicated in the summary and conclusions of the report.

Manufacturing. Boats, trailers, and accessories are currently manufactured in the State. The expected increase in demand for these items would provide greatly enhanced manufacturing opportunities.

Tennessee has an abundance of resources with which to provide the necessary raw materials for marine goods production. Electric power may be obtained at low rates from TVA sources. Extensive supplies of water for industrial use are readily available throughout the State. The relatively large labor supply is of high quality; current low wage rates fail to reflect the high productivity of easily trained Tennessee workers. Low construction costs and inexpensive land for plant sites are other factors favoring the location of manufacturing plants in the State. Moreover, the policies of both State and local governments in Tennessee enhance the profitability of enterprise. These facts indicate the marine goods can be manufactured at low cost in the State.

Tennessee is situated in the center of a large segment of the Nation's market for marine goods. This locational advantage is made more effective by an extensive network of transportational facilities, which makes it possible for Tennessee manufacturers to serve a large market area at low cost. The large and rapidly growing demand for marine goods, low production costs, and accessibility to a large market area promote the establishment of plants in Tennessee.

Some observers believe that boat, motor, and trailer production will probably follow the historical trend of the automobile industry; that is, toward increased concentration of production. Large-scale production, using assembly-line techniques, is rapidly becoming common in the marine goods industry. A few large firms now manufacture most of the outboard motors produced in the Nation.

However, a number of small-boat, trailer, and accessory manufacturers are operating in Tennessee. A majority of them believe that their profits will be even greater in the future, and many of them plan to expand. This will entail the installation of more complex and expensive machinery and control devices. Also, the expanded production will result in increased marketing competition. But the installations will require substantial financing, and more efficient operations will be necessary to assure that the investment pays off. In these circumstances, underfinanced or inefficient firms may find it difficult to survive.

Marketing. Another problem to be considered is the selection of proper marketing techniques. This involves a choice of available methods for marketing the product. The practice of making sales direct to the customer is declining in the pleasure boat industry. The more common marketing method is to utilize the services of middlemen. It is often wise for manufacturers to protect selected dealers by franchise agreements, enabling the manufacturer to exercise greater control over them. This will tend to insure that a good product, which has been well advertised, will be properly displayed, demonstrated, and sold.

While marine goods and accessories used in Tennessee may be manufactured in plants located in Tennessee or elsewhere, the sales of this merchandise will be largely by dealers located in the State.

Businessmen engaged in marketing must apply the principles of good management. The financial requirements for these middlemen are not as great as for manufacturers. However, there is an increasing tendency on the part of boaters to shop where they can purchase at one location all of the marine goods and accessories they wish. Many of the leading marine goods dealers are obliging their customers by carrying a complete line. The financial burden of carrying this great variety of merchandise in stock is therefore increased.

The practice of demonstrating boats and motors is increasing. This means that the dealer must have sales personnel with sufficient knowledge of a great variety of products and an ability effectively to demonstrate their use on the water to prospective customers.

The marine dealer must be alert to changing consumer desires, because there are frequently significant changes in product design in this new industry. He must also be aware of the merchandising practices of his competitors. This industry is becoming more competitive and is subject to increasing price competition at the retail level. Hence, the dealer must adopt sound but flexible pricing practices in order to meet this competition.

The successful dealer must advertise extensively. One of the most effective and least costly methods of advertising is to display as many complete boating outfits as available display space permits.

Rendering Services. More and more services are being demanded by pleasure boaters. These services must be rendered at the lakes where boaters engage in their sport.

The financial requirements for this type of business are not as great as for the manufacturers, but they will increase in the future. A fishing dock with a few boat slips is no longer sufficient. The modern boat dock operator must provide boat houses and concrete launching ramps. Boaters want repair services to be available at the lakes. Partially because boating is becoming more and more a family sport, eating facilities and overnight accommodations must be provided.

The dock operator must serve as a retailer for many types of merchandise. Gasoline is one essential item. Fishing tackle, marine equipment, and numerous other items must also be kept on hand. This means that a sufficient amount of capital will be required.

There will be many business opportunities in manufacturing and marketing marine goods and in rendering services to pleasure boaters in Tennessee. Realization of this potential requires that businessmen in this industry follow sound business principles and establish policies appropriate to the problems which they will face.

About the Study

The data obtained in this study of the pleasure boating industry in Tennessee were gathered through correspondence and interviews with boat manufacturers, dealers, dock operators, and owners of pleasure boats. From the suggestions of these respondents, formal questionnaires were developed and used for personal interviews with individuals in each of the four groups.

It was found that many of the businesses in the industry do not keep detailed records. Therefore, only general information could be obtained in some instances. Also, only a limited number of boat manufacturers, dealers, and dock operators could be interviewed.

part II

ORGANIZE AND ACTIVATE

The National Investors Life Insurance Company of Louisiana[*]

THE COMPANY

The National Investors Life Insurance Company of Louisiana, a legal reserve stock life insurance company, was organized under the laws of the State of Louisiana. The company was organized after the State Legislature had met in 1958 and reconstructed the Louisiana Insurance Code. Under the reconstructed code the requirements for capitalization were increased to $150,000 cash paid in, of which $100,000 is to be allocated to capital, and $50,000 to surplus. However, the National Investors Life Insurance Company of Louisiana organized with $207,750[1] cash paid in, of which $150,000 was allocated to capital, and $57,750 to surplus. This company is much stronger than it, or any other company, would have been if organized under the old laws, which required $125,000 paid in capital and surplus. After proper examination by the commissioner of insurance, the company was granted its certificate of authority to commence business on the eighth day of August, 1958.

The general nature of the business conducted by the company is to grant insurance upon the lives or health of persons and every assurance pertaining thereto; to grant, purchase, or dispose of annuities and endowments; to reinsure all or any portion of its risks and to accept reinsurance from other companies, all at rates based on standard tables secured by the legal reserve required by law; and in general to do all such things and perform all such acts as may be permitted by the laws of Louisiana, or as may be necessary or desirable for the successful conduct of the business of life, health, accident, or disability insurance on the legal reserve plan.

The home office of the company is located at 4521 North Boulevard, Baton Rouge, Louisiana.

Background and Projection

Mr. Jess P. Odom and Mr. Earl B. North co-founded The National Investors Life Insurance Company of Arkansas which received its charter on April 5, 1957, and began selling its charter contracts on January 2, 1958. By December 31, 1959, over $48,000,000 of insurance had been issued and in force.

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[*] Prepared by Preston P. LeBreton, Louisiana State University.

[1] $207,500 cash was received from the Arkansas Security Company in exchange for 1,500,000 shares of NILI Co. of Louisiana stock with par value of 10 cents.

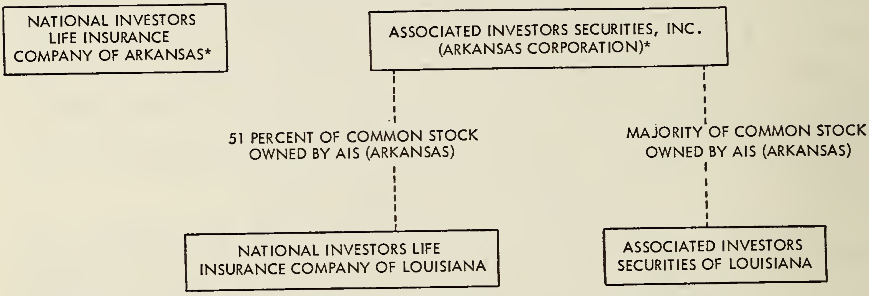
The Associated Investors Securities, Inc., an Arkansas Corporation, was formed in 1957 to serve as a financial vehicle to carry the insurance program into other states and to allow for the buy-back of stock sold to the public.

The Associated Investors Securities, Inc., owns 51 percent of the common stock of the National Investors Life Insurance Company of Louisiana. (See Exhibit 1.)

The Associated Investors Securities of Louisiana, Inc., was organized on May 18, 1959, under the laws of the state of Louisiana. A majority of the common stock is owned by the Associated Investors Securities, Inc. One important purpose of this new Louisiana company is to assist in carrying the insurance program into other states. It will also provide a means for buying back stock sold to the public. It is authorized to sell 1,250,000 shares of common stock with 10 cents par value. Stock sales began in August, 1959. Exactly 786,999 shares were sold to the general public at 99 cents per share by April 19, 1960.

EXHIBIT 1

Relationship of Associated Investors Securities, Inc. of Arkansas with Louisiana Affiliates


NATIONAL INVESTORS LIFE INSURANCE COMPANY OF ARKANSAS*
ASSOCIATED INVESTORS SECURITIES, INC. (ARKANSAS CORPORATION)*
51 PERCENT OF COMMON STOCK OWNED BY AIS (ARKANSAS)
MAJORITY OF COMMON STOCK OWNED BY AIS (ARKANSAS)
NATIONAL INVESTORS LIFE INSURANCE COMPANY OF LOUISIANA
ASSOCIATED INVESTORS SECURITIES OF LOUISIANA

* The two Arkansas companies are financially separate institutions.

The prospectus of the National Investors Life Insurance Company of Louisiana contains a statement of the ultimate aim of the associated life insurance companies:

> The management proposes to request the stockholders of Arkansas and Louisiana, within the next three years, and all other states in which operations are effected, at the appropriate time, to merge the operations together into one large company, thereby gaining position, strength and stability. One can surely visualize that it is highly possible to have a large life insurance company, with several hundred million dollars of business in force, and several hundred agents writing business within the first five (5) years, right here in the immediate area.
>
> The program calls for extending the operations of the company into at least thirteen (13) states within the first ten years. The program also calls for a fire and casualty company to be organized within three (3) years from the date of the first life insurance policy issued. The original stock owners of the life in-

surance company will be given preference in ownership of the fire and casualty company.

The immediate program calls for extending the life insurance operations into at least four (4) states other than Louisiana within the next two years.[2]

Capital Securities (Stock Offering)

On August 15, 1958, the company was authorized by its shareholders to issue 1,000,000 shares of 10 cents par value common stock. Approval of the sale of the securities was issued by the commissioner of insurance of the state of Louisiana on September 16, 1958. The price was set at 99 cents per share, with all of the par value allocated to capital.

The stock was not offered to the public generally. The company restricted sales to 100 shares per individual and 1,000 shares per family. The stockholders who were sought to own the National Investors Life Insurance Company of Louisiana were selected Louisiana investors who were representative of the agricultural, industrial, business and professional leaders of the state. Louisiana is divided into 64 parishes. Units of stock were allocated to parishes on the basis of population as of the 1950 census.

A major reason for this restrictive sale was the desire on the part of management to have wide distribution of ownership. It is part of the company's overall plan that each shareholder will be a center of influence within his community and will thus be able and willing to provide leads for future sale of investment and insurance policies.

The 1,000,000 shares which were placed on the market in September 16, 1958, were sold out on January 17, 1959. A special sales feature was introduced to encourage both the purchase and retention of stock shares. All prospective purchasers were told that they could return their stock at any time up to September 14, 1959, and receive a refund without deductions. Prospective stockholders were also told that the stock would increase on September 15, 1959. As promised, there was an increase to $1.49 per share, with a guaranteed buy-back at this price. At the time of this increase, stockholders were told that there would be another increase within six to eight months. Effective May 5, 1960, the stock took another increase to $1.63 per share. This price, less 10 percent handling charges and Federal Revenue Stamps, has a guaranteed buy-back established and maintained by the Associated Investors Securities, Inc. At this time, May 5, another promise was made for another increase in stock price in approximately six to eight months.

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[2] *The Louisiana Investor*, "Published in the interest of the five segments of personnel: Stockholders, Parish Board Members, Charter Contract Owners, Agency and Home Office of the National Investors Life Insurance Co. of Louisiana," stated the progress of the company and associated companies in the May, 1960, issue as follows:

28 months by NILI of Arkansas	$50,175,795	in force
15 months by NILI of Louisiana	$41,776,000	in force
7 months by NILI of Oklahoma	$14,180,000	in force
Total	$106,131,795	

BOARD OF DIRECTORS

The board of directors is composed of five members. Three are officers of the company and two are outside members. They are Messrs. Blanchard Odom, Earl B. North, Jess P. Odom, Hale R. Shadow, and B. G. Allison.

Mr. Blanchard Odom, born in 1906, is a native of Louisiana. Receiving his education in the schools of Louisiana, he owned and operated his own business for 15 years. Mr. Odom is a veteran of four years service in the U.S. Navy. Prior to his navy service he was employed by Standard Oil of Louisiana in the refinery laboratory. Mr. Odom is active in various civic and fraternal organizations, having served as president and chairman of the Salvation Army of the Ruston district. He is past president of the Ruston Lions Club, a member of the Masonic Lodge of Ruston, a thirty-second-degree Mason, and a Shriner of El Karubo of Shreveport, Louisiana. He was a member of the Ruston Town Council for three years, prior to moving to Baton Rouge. While in Ruston, Mr. Odom was a member of Temple Baptist Church, serving several years as chairman of the board of deacons and teacher of the men's Bible class. Mr. Odom became president of the National Investors Life Insurance Company of Louisiana in July, 1958. He is president of Associated Investors Securities of Louisiana, Inc. He served recently on the board of directors of a Louisiana life insurance company and as president of a finance company doing business in Louisiana.

Mr. Earl B. North is secretary-treasurer of the National Investors Life Insurance Company of Louisiana. Mr. North was born on June 1, 1917, and educated in public schools of Arkansas; he was graduated from Little Rock Senior High School in 1935. Mr. North attended schools of higher learning in the state of Missouri and holds certificates of attainment in accounting and business administration. His varied business experiences lend appreciably to his thorough knowledge and understanding of company operations and management. Mr. North's business and professional experience includes teaching, accounting, company management, sales management, and also experience as president and chief executive officer of a large corporation. For the past several years he has managed a general agency for life, fire, and casualty insurance. He is secretary and treasurer of Associated Investors Securities of Louisiana, Inc., co-founder of the National Investors Life Insurance Company (an Arkansas corporation), and he has served as first vice-president of the latter company since its organization. He is vice-president and secretary-treasurer of Associated Investors Securities, Inc., an Arkansas corporation, and secretary-treasurer of the National Investors Life Insurance Company of Oklahoma. During World War II, Mr. North was an officer in the infantry. He is a business, civic, and church leader. He is a member of the International Association of Lions, having served his local club in all major capacities, including those of president and zone chairman of Lions International. He is a Baptist and is now serving his church as deacon, vice-chairman of deacons, and teacher of the men's Bible class. The high personal production of life insurance over the past several years further qualifies Mr. North in a thorough understanding of the business, and qualifies his statement that, "The life insurance business is the greatest business in the world today."

Mr. Jess P. Odom, vice-president, was born in Louisiana in 1913 and was educated in the public schools of Louisiana. He was graduated from Ruston High School and from Louisiana Polytechnic Institute of Ruston, Louisiana, where he majored in economics and law. Mr. Odom moved to Arkansas in 1936, and was manager of a large chain store there for seven years. He established his own business in 1941, successfully operating this business for three years prior to entering service in World War II. After separation from the military service in 1945, he again entered business for himself, and has continually operated his business, highly successfully, for 12 years. For several years Mr. Odom has been active in the life insurance industry. He is chairman of the board of Associated Investors Securities of Louisiana, Inc. In conjunction with Mr. Earl B. North he organized the National Investors Life Insurance Company. He is president of the National Investors Life Insurance Company, president of Associated Investors Securities, Inc., an Arkansas corporation, vice-president and director of the National Investors Life Insurance Company of Louisiana, and chairman of the board of the National Investors Life Insurance Company of Oklahoma. Jess Odom has been active in church and civic affairs in his town, community, and state. He has served as district governor of Lions International, chairman of the Southwest Rehabilitation Center for Adult Blind in Little Rock, Arkansas, and president of the Mid-South Lions Sight Service, Memphis, Tennessee. He is a Baptist, serving his church as department superintendent of Sunday school, and president of Arkansas Valley Associational Brotherhood. He has also served his community as president of the Chamber of Commerce, president of Business Men's Club, and president of the Booster Club, and is, at this time, International Counsellor of Lions International.

Mr. Hale R. Shadow is president of the Coca-Cola Company in Ruston, Louisiana.

Dr. B. G. Allison is professor of Theology, Baptist Theological Seminary in New Orleans, Louisiana.

The board meets on the second Saturday of each month. Major policy activities and long-range plans are discussed by board members. The implementation of plans is handled by the president of the company.

Parish and Advisory Board

The affairs and business of the company are conducted and controlled by the board of directors through its duly appointed officers. Supplementing the

> board of directors and company management in their administration is the parish and advisory board, consisting of a maximum of twenty-five (25) business and professional men throughout the state, and at least one parish board member from each of the 64 parishes in the state working together in its official capacity.
>
> The managing personnel of the National Investors Life Insurance Company of Louisiana are men of long and successful experience in the administration of a life insurance company. As a result of such experience, they are familiar with the need for, and the advantages of, an auxiliary body representative of all sections of the company's domiciliary state and operating territory, complementing management in its administration of the company's affairs. Such advantages as the equitable and favorable allocation of the company's capital structure, personnel recruiting and selection, planning and projection of initial and subsequent phases of the company's program, and investment advice and selection at the local level are obvious. The value of ready accessibility of outstanding resident individuals for counsel on all matters pertaining to the company's affairs is also unmistakable. Of considered importance also is the continued future relationship of the company with its stockholders and policyholders alike.
>
> Through the parish and advisory board members, composed of representative community leaders, geographically identified, these facilities are made possible. Provisions for this important managerial supplement from the inception of the company places the National Investors Life Insurance Company of Louisiana in a uniquely advantageous position in the field of advanced industry functioning most conducive to effective operation, growth and profit potentials.[3]

Advisory board members hold an honorary position and receive no remuneration for services rendered. They were paid travel expenses when asked to attend meetings away from their home town. A formal meeting is held every six months with advisory board members and the board of directors in attendance. They assist the company in solving problems which develop in the field by providing advice to company officials. Parish board members are licensed under agents' contracts and receive $50.00 for every $10,000 unit sold through their assistance.

THE PRESIDENT AND EXECUTIVE ASSISTANT TO THE PRESIDENT

The President

Mr. Blanchard Odom, as president, is the chief executive officer of the company. He was the president and only member of the organization when it began operations in July, 1958. Working under the general policies set down by the board of directors, he has been primarily responsible for the steady growth of the company. He still maintains fairly tight control over all important activities of the company. Copies of all reports prepared by departments are sent to the president and copies of all correspondence, without exception, are sent to him before being mailed. This procedure serves both as a control device and as a means by which the president is kept informed of all company activities. In turn, he sends copies of his correspondence to the executive assistant to the president to keep him informed of all significant action taken by the president. Approval of all major activities rests with the president, including the hiring of all personnel, but the hiring function was turned over to the personnel officer on June 1, 1960.

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[3] Source: Prospectus—The National Investors Life Insurance Company of Louisiana.

The president keeps informed of departmental activities, introduces new plans to the organization, and solicits opinions and ideas of department heads through frequent meetings with the staff. There are weekly meetings with department heads, the president presiding at these meetings. Once a month the board of directors meets in Baton Rouge. Major long-range plans are discussed and formulated at these meetings. For example, at the present time plans are under discussion for the establishment of new companies in Kentucky, Florida, and Mississippi. In Mississippi the intention is to simply qualify the Arkansas company. In the other two states new companies will be formed. A decision has not yet been made whether the Louisiana or Arkansas company will take the initiative in setting up the companies. The president is currently engaged in formulating plans for several crucial projects which are typical of the diversity and level of problems normally associated with his work. The general problems of expansion into other states, through the formation of new companies, and the expansion of activities in Louisiana are of constant concern. A more immediate problem is associated with the pending shift in emphasis from the charter life contract to ordinary life contracts. This action will require a major shift in the selling approach to be used and will require that all agents as well as managers be fully trained in the new contract provisions. A training program is already underway to satisfy this need.

A second program need is associated with the new investment opportunities provided by the formation of the Louisiana Investors Company. A third program is designed to obtain maximum support and cooperation from all parish board members and advisory board members. To this end the president is presently engaged in meeting personally with various parish and advisory board members in a concerted effort to improve their contribution to the company.

Executive Assistant to the President

Mr. D. P. Nickel was born on July 4, 1917, in Fresno, California, where he received all of his formal education through high school. His experience in the insurance field began in 1950 when he joined the National Old Line Insurance Company domiciled in Little Rock, Arkansas. He was employed as a company representative in Greenville, Texas, and was shortly moved to Austin. He was promoted to district manager and then to Southern states supervisor in San Antonio. He was a consistent $1,000,000-a-year producer. In May, 1956, he went to Little Rock, Arkansas, to join with three others to form the American Foundation Life Insurance Company. He served as agency superintendent with the new company. In February, 1960, he joined the National Investors Life Insurance Company of Arkansas as conservation and public relations head. After eight weeks he was brought to Louisiana as executive assistant to the president of the Louisiana company.

As executive assistant, Mr. Nickel is directly responsible to the president and is responsible for executing the decisions made by the president. Presently his major job is to serve as a buffer for the president who has a tremendous overload as a result of the great expansion of business and manpower. Mr. Nickel has been with the Louisiana company since April, 1960, and has spent considerable time orienting himself in the details of the company's operations and in becoming acquainted with the home office management team. There is no fixed job description for the executive assistant at the present time because of the newness of the position and because the final decision has not yet been made as to the specific responsibility of the position. A few specific assignments do indicate the general direction in which the position responsibilities are likely to go. The executive assistant gives preliminary approval on all requests for salary adjustments, cooperates in procedural changes in all departments, initiates training programs for the education of agents and managers in orthodox insurance plans, and works with the home office in Arkansas on the development of new insurance plans to meet the specific and changing needs of the people of Louisiana.

STATE MANAGER

The primary responsibility for the supervision of the sales and supervisory staff is in the hands of John W. Brister, Jr., the state manager. Mr. Brister was born on August 29, 1927, and reared in Winn Parish where he attended the public schools. He spent two years in the United States Navy. He was in business for himself for 10 years and was employed by the Department of Veterans Affairs for two years. Mr. Brister joined National Investors stock sales force on October 15, 1958, selling stock over the entire state. He was a life representative from January 26, 1959, until May 1, 1959, when he was promoted to district manager. On September 1, 1959, he was promoted to division manager. He was one of eight million-dollar producers, and on March 1, 1960, he was promoted to state manager.

Mr. Brister is married and has three children. He is a past president of Winnfield Kiwanis and a member of Eastern Star Lodge No. 151 F & AM. He is a member of East Winnfield Baptist Church where he has taught Sunday school and directed some of the youth activities.

Territory

The state of Louisiana has been divided into five divisions with each division being subdivided into two districts, thus making a total of 10 districts. This division of the state was done on the basis of population figures from the 1950 census and the number of shareholders. The assignment of representatives within each parish reflects the size of the parish and the number of stockholders in the parish.

Recruiting and Selection

Agents are selected from within the territory in which they will be expected to sell. Any agent, district, or division manager may suggest a person as a possible candidate. An application is completed and sent to the home office. A credit report is made. The state manager gives his recommendation to the division and district managers. The desired qualifications are: interest in selling life insurance, willingness to work hard, good appearance, and good reputation in the community, male, married, high school graduate, age between 25 and 40, some experience (but the company training program is a substitute for any lack of experience), and perhaps the ability to speak French or Spanish if the applicant is being considered for south Louisiana territory.

District managers all come from the ranks and are usually assigned to the district in which they were selling. Major qualification desired is a good record of production as an agent. Without a superior record as an agent it is believed that it would be difficult to get loyalty and cooperation of other agents. Qualities of good public relations and leadership are also desired.

The qualifications for a division manager are the same as for district managers. In addition, he must have demonstrated a capacity (as district manager) to work with people.

Training and Developing

Each new agent goes to the home office for a one-week training program in which he learns the basic contract, the art of presentation, and the general operating procedure of his unit. He receives no salary at this time but gets an expense allowance of $9.00 per day. Once each six months a division or two may be called in for a two-day refresher course.

The district manager goes with the agent on his calls until the agent becomes a producer. This procedure may take two or three days or two or three weeks. The manager makes the actual sales talk to the interested party with the agent observing. Then the agent will try with the manager observing. After this experience, the manager has a critique with the agent.

All agents attend a regular Monday morning meeting (9–12) held by the district manager. This is a motivating meeting in that the district manager attempts to stimulate the agents to higher production for the period. It also affords an opportunity for the manager to give individual counsel where it is most needed. The manager also keeps the agents informed regarding important new developments at the division or home office level.

There is a meeting of division managers with Odom, Simmons, Nickel, and Brister every other Friday morning at the home office. This meeting provides a chance to test new company policies and programs on division managers before they are published for district manager and agent use. That same afternoon the district managers meet with the above group. This meeting gives the district manager a chance to report on progress, ask questions, and get a first-hand report on new policy and procedures. Currently all managers are taking a course—An Introduction to Life Underwriting—which includes such topics as rate building and the use of the social security program in preparing an insurance program for a client.

Compensation

All agents are paid on a straight commission basis. Agents receive a 55 percent commission on first-year premiums and 10 percent on renewals. A new representative can draw up to 60 percent of his first-year commission. Field managers can hire an agent and promise him a $100 to $125 a week return. Should the man be terminated within 5–6 weeks and should there be indebtedness, the district manager and division manager would be charged one fourth of the expense (each) and the company would suffer the one-half loss. This policy has been introduced to encourage better selection of agents.

Established representatives receive a full commission with advance up to 60 percent of commission earned for the year. The procedure followed is to have the agent send in the delivery slip indicating that the contract has been turned over to the purchaser. From the delivery slip the IBM card is prepared and processed. This IBM statement authorizes the preparation of a check for the agent. In the future, as a contract holder pays his premium the agent receives his commission.

A district manager receives a 6 percent override on all business sold in his district (annual premium). There is no override on renewal on business sold in his district. There is a floor under the district manager with a guarantee of $600 per month. He is furnished a car (Avis rental of $145.75 per month) plus $100 operating expense allowance. When he is working with an agent and a sale is made, the district manager receives 13 percent plus 6 percent override and the agent receives 30 percent. All renewal commissions are split with the agent. Each receives 5 percent of the annual premium.

The division manager receives the same car allowance as the district manager. He receives no guarantee—any advance received will be charged back to him. He has a weekly draw of $200 and receives a 6 percent override on all business sold in his division. This override is charged against the $200.

Special Promotion

Various contests are held among representatives to encourage sales and a healthy spirit of competition. Two typical contests can serve as examples: a state meeting is held at which all representatives are divided into two groups according to sales record during the contest period. At a banquet, the upper half are served steak or chicken and the lower half peas and cornbread. Another type of contest includes a qualifying point and prizes such as shirts. Every agent meeting the standard receives a prize and as additional units are sold additional prizes may be won.

There are also contests in which managers participate. The average production of the previous two months for each district is set as a base. The goal is to maximize production beyond this base. A separate goal is set for each district based on individual district past record. The five top district managers (who exceeded a certain percent of their goal) will go to Grand Isle, Louisiana, for a two-day fishing trip with all expenses paid.

Division managers will have the same type of goal and the top three will be given 20 shares of incentive stock valued at $1.63. The top three representatives in the division will be given 10 shares at 50 cents if he has been with the company for six months.

Each month a trophy is given to the top producer and top CWA (cash with application) representative, and each month a trophy is also given to the manager who has the greatest sales in his division. At the end of the year the trophy is given (to keep) to the manager who has won the monthly trophy most often. A trophy is given each year to the division manager who has top production per man (average).

Major Responsibilities of Managers

The district manager is the first line supervisor of all field representatives. In this capacity he has primary responsibility for training and motivating representatives and coordinating their efforts. Through the effective performance of these functions, he should achieve the major objective of his district—maximum production.

The division manager has the primary responsibility of giving direction, stimulation, and guidance to his district managers. Because of the nature of the company's product (insurance contract), he shoulders two additional responsibilities. One is conservation and the other is public relations. (See section on Conservation Department for description of this responsibility.) In the public relations area he must take action to satisfy disgruntled applicants or shareholders or to correct untrue or misleading statements about the company made by competitors or others.

Since the National Investors Life Insurance Company of Louisiana is a relatively new company selling a unique insurance contract and is highly successful, it is understandable that competitors and others may react unfavorably.

The state manager is responsible for the overall planning, direction, and control of the agency department.

Control

Each representative sends a weekly report to his district manager. This report includes activities of the representative and possibly a request for a drain against commissions earned. A summary of this report —called a district manager's report—is sent to the state manager by the district manager. It includes the name of each agent, the number of calls made, the number of presentations made, the volume and kind of sale made, a request for advance, the approval or disapproval by the district manager of the request, and general remarks. The district manager sends an additional weekly report to the division manager and the state manager. This report is a day-to-day breakdown of the activities of the district managers relative to their work with agents. It includes the names of agents he has worked with, the number of calls made, the appointments met, the management presentation or agent presentation made, the volume of standard or other policies sold, and remarks.

An agent's monetary standings report is prepared by the office of the state manager. This report goes to the district managers. It includes the name of the agent, the commission earned to date, the total draw to date, the amount of recent draw request, the amount of the check, and remarks. When an agent has already drawn above 60 percent of his yearly commission earned, the amount of the requested draw may be reduced.

A production report by districts for a 13-week period is issued by the home office and sent to each district and divisional manager. It contains:

1. Total sales per district and average weekly sale.
2. Average weekly commission earned in each district by the district manager.
3. Summary statement of the percent of commission earnings to the total money received (or cost to the company) by district manager. This report can show at a glance which districts need special attention.

Copies of all outgoing correspondence go to the president of the company. Weekly production reports are sent to the Arkansas company.

Future Plans

The future plans of John W. Brister, Jr., for the department are:

1. To teach the Life Insurance Manual to all representatives.
2. To try to cultivate the idea of insurance as a career (many agents are not sold on the industry, or they are not willing to work sufficiently hard to maximize their contributions).

3. To increase production in all weak districts.
4. To exceed the previous year's record of sales.
5. To make the agency department the best in the company.
6. To cut down on over-time in the office.
7. To help build one of the largest insurance companies in America.

CONSERVATION AND PUBLIC RELATIONS

Mr. M. A. Simmons was appointed head of the Department of Conservation and Public Relations on April 1, 1960. The basic activity of conservation is to reduce the lapse ratio on existing accounts. Although the lapse ratio to date is thought to be good, in view of the volume sold, the problem of maintaining accounts is ever present in the insurance industry. This function is extremely important because the company makes a higher return (net return) when a contract is held beyond the first year. Most of the premiums paid within the first year go to commissions and processing costs.

General Procedure

The contract provides for a grace period of 31 days, during which the insurance will remain in full force. Unless previously surrendered, the policy may be reinstated at any time upon evidence satisfactory to the company of the insurability of the insured and payment of all past due premiums with interest thereon at the rate of 5 percent per annum, compounded annually, from their respective due dates and the payment or reinstatement of any other indebtedness to the company on account of this policy.

The general procedure for handling accounts not paid by due date follows:

1. Thirty days after due date the accounting department sends a notice to the policy holder, the agent, the division and district managers, and the conservation and public relations department head.

2. Sixty-one days after due date the accounting department sends a lapse report to conservation. This report, plus reinstatement forms are sent out by conservation to the representative of the department (divisional managers). These reports come daily from the accounting department.

3. During the 61-day grace period, conservation may make direct contact (letter or in person) with the insured as well as the agent, division, and district managers. A letter to the agent will include a statement of how much he will lose in commission if the account is not continued.

4. After the 61-day grace period, a representative of the conservation department (divisional managers) makes direct contact with the insured. If he conserves the business and there is a deferred and renewal commission, the commission will go to him. If the head of the conservation

department does the conserving after 61 days, all commissions will go to the company. If anyone other than the conservation head gets reinstatement of a contract, the district and divisional managers share in the override as they would under normal conditions.

Control

The head of the department receives daily notices from the accounting department of 30- and 61-day overdue accounts. Each representative of the conservation department will complete a detailed form explaining the degree of success or failure achieved in attempting to reinstate an expired contract. This form is returned to the department head upon completion of the interview.

There is a plan for use of a form which will provide valuable information before a contract reaches the lapse stage. This form will be sent to agents (selling representatives) to be taken to contract holders for their comments and signature. The forms will be used to learn more about the customers and their feelings and problems and to get their suggestions as to how the company might improve its services. The customers to be contacted will be selected on the basis of need for company public relations efforts. This does not mean that only disgruntled customers will be interviewed, but rather that they will be given priority treatment. The completed and signed forms are then sent to the head of the conservation department for his interpretation and use.

Manpower

At the present time each divisional sales manager is a representative of the conservation department. They report to the conservation and public relations department head in matters relating to conservation but to the state manager on all other matters. It is probable that as the company grows, additional men will be hired to work full time with the department.

Mr. M. A. Simmons was born on December 4, 1912, in Sikes, Louisiana. He is married and has two daughters. His major hobbies are bowling, fishing, and hunting. From 1937–40 he was employed by the Life and Casualty Insurance Company of Nashville, Tennessee, as agent, special agent, supervisor and head of training and hiring. Between 1946 and 1948 he was employed by Mutual of Omaha and United of Omaha as salesman, supervisor, and head of hiring and training. While working in this capacity, he was a member of the Million Dollar Club and "The Criss Club," the highest award given by the company. He ranked number one in the entire Southwest the last nine years of service with the company. During his last year of service with the company he ranked number eight in the entire nation. He joined the National Investors Life Insurance Company of Louisiana in 1958 as a salesman, was promoted to division manager and then to his present position as head of public relations and conservation.

UNDERWRITING AND PURCHASING

Mr. C. G. Gates is the underwriter and purchasing agent for the company. Mr. Gates was born in Shreveport, Louisiana, on May 8, 1929, and was educated in Shreveport elementary schools. He was graduated from C. E. Byrd High School in May, 1946. Upon graduating from high school he was employed full time by the Southern Production Company, Inc., of Shreveport. While with Southern Production, Mr. Gates was fixed capital accountant. As fixed capital accountant, Mr. Gates supervised seven women employees who kept records of fixed capital and made quarterly statements of the company's fixed capital. He also assisted management in preparing annual budgets and federal tax returns and supervised and trained two men and three women in machine accounting.

While employed by Southern Production Company, Mr. Gates attended night classes at Centenary College for two years, studying accounting and business law. He then studied accounting through the International Accountants Society Correspondence School, completing courses in general accounting, cost accounting, auditing, and income tax accounting.

In October, 1955, Mr. Gates assisted in the capitalization of the Acme National Life Insurance Company of Louisiana. On completion of this work he was elected chief underwriter and office manager. He served in this capacity until September, 1957, and was then elected assistant vice-president and to the board of directors. While serving in these capacities he was responsible for the underwriting, policy issuing, purchasing, accounting system and procedures, printing of all company forms, composing policy forms and applications, and the rate book, reinsurance procedures and claims from the ordinary, industrial, and hospitalization departments. He assisted management in determining company policy, hiring and training agents, and composing sales-kit material.

Mr. Gates' employment with Acme National Life terminated in March, 1958, when he was elected assistant secretary of the Acme National Securities Corp. of Louisiana. He served in this capacity until his resignation on August 1, 1958.

On November 1, 1958, Mr. Gates was employed by the National Investors Life Insurance Company of Louisiana in Baton Rouge, Louisiana, as office manager and underwriter. His present position is that of underwriter and purchasing agent. There are two full-time employees reporting to him.

Major Responsibilities of Underwriting

Mr. Gates finds it convenient and useful to separate the total responsibility for underwriting into three parts: decipher, development, and decision. The deciphering of an application is concerned with the interpretation of the agent's writing. Development activity takes place when the application is incomplete or inaccurate and to provide the necessary supplemental information. Attending physician's statement, for example, is a form not usually supplied by applicant or agent. The decision activity is the final acceptance or rejection of the application and the "grouping" of the prospective insured.

Gates performs the first two activities, while the final decision is made by the chief underwriter in Arkansas.

Application

A clearer understanding of the functions and responsibilities of the underwriter can be had by selected reference to the application form and other required forms. The application is divided into three main parts:

Part I.
1. Body of the application (contains 16 items).
2. Authorization statement (attached) (authorizes any doctor who has treated applicant to give underwriter information he requests).
3. Receipt (attached) (for money, received by agent in payment of premium).
4. Agents report (on reverse of application) (agent's evaluation of applicant).

Part II.
1. Statements to the medical examiner (doctor's questions to be answered by applicant).
2. Authorization statement (attached) (authorizes examiner to make the examination and forward findings to underwriter).

Part III.
1. Medical examiner's report (list of points to be specifically examined by doctor).

Procedure Followed in Processing Application

The following general procedure is used in the processing of applications:

1. Application is sent from the agent in the field to the accounting department in Baton Rouge. The cash received with the application is taken from the application and deposited. The amount is recorded on the application and register. Underwriter work sheet is prepared identifying the agent to receive the commission.
2. Application goes to clerk who checks status (in force or previous application). If there is a previous application, he draws out the previous application and it follows current application through cycle.
3. Application goes to the underwriting department. A clerk completes typing of worksheet, prepares file, and starts underwriting process. He orders any additional information needed. The application then goes to the underwriter who checks work already done and requests any additional information needed (has it ordered). All files are put into pending files.
4. Dates file and 10 days after the information is requested, if it is not received, he sends follow-up.
5. Dates file 10 days from new date. If information does not come in on schedule, the application is up for cancellation as incomplete. Sends

refund check to district manager. If district manager can complete application, agent receives no commission.

6. When all information is complete and developed as far as possible, it is sent to Little Rock, Arkansas, for underwriting decision and re-insurance (in Little Rock the same procedure is followed as in Louisiana). The underwriter decides what group it is to go in.
7. This application then goes to issue department as Little Rock. This department verifies premium calculation.
8. The next stop is the policy typist (contract). An accounting card is run off, and tab card, reserve card, premium record card and agent's cards are prepared.
9. The contract is sent to Baton Rouge. The accounting department records data in alphabetical order and in numerical card file. It stamps alphabet card with date received and name of agent contract is to be sent to for delivery.
10. The contract goes to the agent—with delivery slip to be signed by the insured, and transmittal notice, if necessary, and tablet talk (work sheet which shows benefit of contract—what was said and what contract says). This work sheet had been signed by the insured at the original time of sale.
11. Premium payment notices sent out by accounting department.
12. Any modification of contract through underwriter in Baton Rouge.

General Information of Value

The Group Concept. The insurance code says that a company cannot discriminate on rates—similar risks carry the same rate. People are rated or not rated depending on the group in which they fall. There is not an individual rate. The home office underwriter decides what group the person falls in.

Among other factors, the group assigned is influenced by: age, sex, living conditions and environment, occupation, family history, reasons for buying insurance, medical history, habits and morals.

Appeal. If an applicant feels that he has been unjustly grouped, he may provide additional information to show why the group placement is incorrect.

Confidential coded information is exchanged between and among companies on a confidential basis. This practice is helpful in getting the complete insurance history of a person.

Rejection. After all the above information is available, a decision is made. There is about a 1 percent rejection of applicants.

Re-insurance is used because of the use of relatively inexperienced personnel, the lack of complete knowledge of all factors relating to an applicant, a desire to share the risk, and because it insures the company against disaster. The Lincoln National Life Insurance Company of Fort Wayne, Indiana, Republic National Life of Dallas, Texas, and Business Man's Assurance are three companies used by National Investors. There are two basic provisions in each contract. The re-insurance company automatically backs all contracts over $10,000. For contracts of $10,000 and under the company does not have to re-insure. If it does, then the minimum amount to be re-insured is $500.

Control

There are several control devices available. Control over the performance of agents can be had by use of the Application Information and Supplement to Application forms. These forms are sent out to agents requesting additional information which should have been included in the original application. Copies are sent to the district and division managers who supervise the agent.

Similarly, the chief underwriter in Arkansas and the underwriter in Baton Rouge (Gates) have a check on Gates. Should he fail to supply adequate information to Arkansas, he will be requested to prepare and submit the required data.

Control over the entire underwriting process (Louisiana and Arkansas combined) is had by reviewing the amount and number of claims paid, the percentage of conservation, and the number of rejects of applicants.

Future Plans

As expressed by Mr. Gates, his expectations are: "Improving upon existing procedures. The company is planning to go into the re-insurance field for National Investors Company. I would like to be in charge of all phases of re-insurance, in charge of the division. Then my talents and knowledge would be utilized more fully."

Purchasing

As purchasing agent for the company, Gates passes on all requisitions submitted by other members of the company. If he should disapprove a requisition, however, the requisitioner is free to go to the president for his decision. Supplies and equipment are currently purchased from a selected list of vendors. This list was prepared by Mr. Gates after he had contacted several suppliers within the Baton Rouge area. His selection of preferred vendors was based on cost and availability of materials.

THE OFFICE OF THE CHIEF ACCOUNTANT

The chief accountant and head of the accounting department is Mr. Reeves, who was born in Camden, Arkansas, on September 28, 1932. He was graduated from high school at Little Rock Central in 1950. He attended Ouachita Baptist College, graduating in 1955 with a degree in business administration. He then served two years in the armed services, attaining the rank of first lieutenant.

Upon separation from the service he attended both the University of Houston and University of Arkansas, taking courses in accounting. Mr.

Reeves then joined the National Investors Security Company of Arkansas and audited its stockholder records and books of original entry. He stayed with this company four months when he was given the opportunity of joining the Arkansas Life Company. He accepted this offer and seven months later he was transferred to the Louisiana office at his present position.

Mr. Reeves has eight full-time employees in his department. Seven of these subordinates have work assignments directly concerned with the National Investors Life Insurance Company of Louisiana. One employee performs work primarily for the Security Company. Fairly detailed job descriptions have been prepared by Mr. Reeves for each position. There is a clear-cut separation of job functions with no excessive overlap of duties. All employees of the department are women, and one member is the assistant to Mr. Reeves, helping him in the supervision of the daily activities of the department.

Control

The internal control is viewed by Mr. Reeves as follows:

> A great volume of transactions in receiving money for premiums and giving the agents the correct commission takes place daily. Mistakes are made of course, but we try to keep this at a minimum; and when mistakes are brought to our attention by IBM, agents, or PBM's then we know that our efficiency is falling and we take steps to correct the situation. I can also compare the number of girls that I employ with that of the companies doing a comparable amount of business and see if we are staffed with the proper number of workers. I consider my work efficiency improving when the corrections and mistakes of the department are decreasing—I can have a good idea because the majority of the complaints come across my desk.

Long-Range Plans

Reeves' plans for the future are:

> To design new forms to facilitate control and accuracy of money received —change of office procedure to avoid duplication of work and improve efficiency. I have designed a new CWA card that is working out very well. I have made several changes in records. I am taking a course from the Life Office Management Association—an organization for home study in the insurance industry.

THE ATTORNEY AND ASSISTANT SECRETARY

Mr. Earl K. Oswalt, attorney and assistant secretary, was born in Mississippi in 1934. He received a B.S. degree in agriculture from Louisiana State University in June, 1956, and an LL.D. degree from the same institution in June, 1959. He was married on June 27, 1959. He joined National Investors on September 1, 1959.

General Description of Job Responsibilities

The specific responsibilities of Mr. Oswalt are in a state of adjustment due to the growth of the company and a shift in personnel within the company and between affiliates. For example Mr. Wilder, who was vice-president of the company and is now executive vice-president of the Oklahoma company, handled most of the affairs of the Security Company. Some of the activities previously handled by Wilder are now handled by Oswalt, Blanchard Odom, and Nickel.

Mr. Oswalt's responsibilities with the Security Company include the preparation of a weekly security letter that goes to selling agents engaged in selling capitalization stock in Associated Investors Securities of Louisiana, Inc. He also answers correspondence from the field.

His responsibilities as attorney for the company cover all legal matters. Because of the relative newness of the company, much of his work is investigatory in nature. Typical questions he attempts to answer are: Should the company carry workmen's compensation insurance on field agents? How are dividends paid to contract holders to be taxed? What insurance ownership arrangements are allowed in Louisiana? Also, because of the newness of the company and general lack of knowledge of law of other company members, he has the responsibility of taking the initiative for seeing that proper procedures are followed. For example, he noticed that the company pays a $4,000 premium for insurance coverage that may not be necessary. Workmen compensation may not apply to the field representatives. If not, it would result in substantial savings for the company.

As assistant secretary he is custodian of bonds and stocks held by the company. He gives some general assistance in investment advising. However, the company has an investment advisor in Arkansas for all affiliated companies. The Louisiana company also has a legal advisor on a retainer in Baton Rouge. There is a general counsel in Arkansas who makes all the important legal decisions. He decides on documents and papers to be used throughout the affiliated companies.

Oswalt views his major problem as one of human relations—working with people. He sees this as a twofold problem. One problem is simply making his services available to those who could use his specialized training. The other problem centers around his advising or decision function. Frequently he is asked to give advice under stress conditions. For example, the wife of an agent who died felt that she should get the full commission on a contract sold rather than the 50–50 split which was made. Her husband had made some of the initial contacts but the district manager made the actual sale. The attorney was asked to mediate this dispute.

Oswalt highlights December 30, 1960, as a significant point of change in the operation of the company. This change will occur because most of the charter contracts of the Life Company will have been sold by this date requiring emphasis on other types of insurance policies. This date should also represent the completion of the sale of capitalization stock in Associated Investors Securities of Louisiana, Inc. Oswalt feels that the company should anticipate these changes and plan for the new situation. In the past, partly because of the newness of the company, too much emphasis has been placed on day-to-day operations and not enough attention given to long-range plans. In particular, there has been an overemphasis on production and not enough thought given to the training and selection of division managers.

At the present time a personnel consultant (hired by Oswalt) is preparing a report on the recruiting and selection techniques of the company. Oswalt anticipates that he will be given additional responsibility over personnel activities as they relate to the entire Louisiana company.

Superior Foods, Inc.[*]

Growth Problems of a Small Manufacturer

Superior Foods, Inc., was a small, well-known manufacturer of canned-meat specialties—distributed through brokers to customers in some 30 states and 18 foreign countries. Prior to 1959, and for more than a half century, all of Superior's manufacturing had been carried on at one plant located in a medium-sized Texas community. Then, because of several related developments, in July, 1959, a second plant was opened in a small rural Georgia community under a lease-purchase agreement.

Superior's board of directors considered the new Georgia plant to be a long-range necessity resulting from: (1) increased expense and difficulty of supplying the Southeast market, (2) growing sales in the Southwest, and (3) excessive overtime at the Texas plant. Such possible benefits as overtime reduction, freight savings, inventory reduction, and improved customer service also influenced Superior's decision to build a plant in Georgia in preference to undertaking either a two-shift operation or a major expansion at the company's main plant in Texas. Completion of the Georgia factory with its adjoining warehouse in July, 1959, increased Superior's productive capacity nearly 40 percent. However, during the 1960 fiscal year, ending June 30, 1960, total annual company sales dropped to $9.1 millions, or 4 percent below 1959 (Exhibit 1). The resulting loss of $57,877 for the year 1960 was the first incurred by Superior Foods, Inc., in 21 years.

EXHIBIT 1

SUPERIOR FOODS, INC.
Trend of Sales and Net Profit
1935–60

Five-year averages: *Period*	*Annual Sales*	*Annual Net Profit*
1935–39	$ 580,000	$ 4,000 (loss)
1940–44	824,000	17,000
1945–49	2,870,000	58,000
1950–54	6,320,000	57,000
1955–59	7,920,000	92,000

Past five years: *Year*	*Annual Sales*	*Annual Net Profit*
1956	$7,190,000	$ 75,800
1957	7,813,000	70,800
1958	8,793,400	131,600
1959	9,580,800	106,100
1960	9,107,300	57,900 (loss)

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[*] Prepared by Virgil A. James, University of Texas.

Referring to these developments and to Superior's future outlook, Mr. William F. Carter, president, made the following comments in his 1960 annual message to company stockholders:

> I would like to start this letter by referring to the last sentence in my letter to you dated July 24, 1959: ". . . most of all, we need to make our two-plant operation a success—though it may take two years for its full profitability to be realized—and thereby lay the foundation for further expansion in the future."
>
> In the first year of our two-plant operation, Superior sales showed substantial gains in the four states of the southeastern part of the United States, particularly in the Georgia area where, as you know, our new plant is located. Total dollar sales for all territories were the second best in the history of Superior, being exceeded only by the record sales experienced the previous year.
>
> As you will note from the Balance Sheet, our cash position is greatly improved over a year ago. The ratio of Current Assets to Current Liabilities is slightly more than 2½ to 1, as compared with the year ago figure of 2 to 1. I also call your attention to the greatly reduced Notes Payable and Accounts Payable items, and to the substantial reduction in inventories.
>
> Your management realized that the investment in new plant facilities, plus certain non-recurring expenses involved in getting the new plant operating efficiently, would reduce the profit. Furthermore, a great deal of extra money was spent for advertising and promotion in the southeastern area, with the hope that we could force distribution in a short period of time.
>
> As stated above, we did show a substantial sales gain in the southeastern area; however, because there were bargain prices on pork, chicken, and fish, as compared with beef prices, it has been reported that all canners of beef products experienced decreased sales throughout the country. Nevertheless, our total dollar sales would have almost equalled the record dollar sales of the previous year, had it not been for our withdrawal from the California market. We withdrew because, due to competitive conditions and freight disadvantages, what business we did out there was done on a loss basis.

Company History

Superior Foods, Inc., had its beginning in Texas around the turn of the century as the B. T. Watson Manufacturing Company. Because of financial difficulties, creditors reorganized the company in 1914, naming as president, Mr. Frank Carter (then representing a Southwest bank) and as vice-president and manager, Mr. W. F. Goodwin (a veteran "troubleshooter"—brought in from the outside).

The new management gradually disposed of various Watson properties —including a pickle factory, an ice house, a wholesale grocery, a cotton gin, and a spinach farm—and retained only the chili, tamale, and chili powder business. "Watson's" products became widely known as the company prospered. By 1932 the Watson family's investment and all creditors' claims against the firm had been paid in full, making possible incorporation of the firm under the new name of Superior Foods, Inc. Over the next few years the severity of the depression was reflected in both company sales (high $900,000; low $460,000) and company profits (high $30,000; low $40,000 loss). Losses during this period amounted to more than profits. Employment totaled about 80–90 persons.

In 1943, Mr. W. F. Goodwin—known to his associates as a "one man organization"—was made credit manager and (honorary) executive vice-president. In addition, Mr. William F. Carter, son of the president, was named general manager and chief executive officer. William F. Carter described the challenges confronting Superior Foods, Inc., in 1943 as follows:

> At that time, Superior Foods, Inc., faced what I considered to be three major long-range problems. First, there was a lack of organization, of delegation of sufficient authority. Some junior executives had been dominated so long that they couldn't accept added responsibility so we eventually went outside the organization for men to fill several major positions. The second problem was the factory in Texas (the only company factory at the time). It needed complete overhaul to improve equipment, layout, and worker efficiency. The third major challenge was how to improve Superior's system of product distribution, as the firm had achieved only limited success under its sales organization.

Except for initiating a reorganization of the company along functional lines and modernizing the factory layout, Mr. William F. Carter was forced by wartime shortages and restrictions to postpone further action on the aforementioned problems. Meanwhile, Superior supplemented its civilian business by packing canned meats and meat-and-vegetable stew for the U.S. Army. Shortages persisted for awhile after World War II; but once supplies became plentiful, the company experienced substantial growth—mostly from the sale of new products.

In 1950, Mr. William F. Carter was made president of Superior Foods, Inc., and his father became chairman of the board. That same year, a new high-speed production line was installed in a new two-story brick addition to the Texas plant, thereby doubling its total capacity.

As production began pushing sales, managerial concern shifted to the sales organization. A new sales manager was hired in 1952 and given responsibility for the marketing function. According to Mr. William F. Carter, president: "He didn't work out well, but he did bring in an able assistant—Mr. Earl J. Glass, who replaced him as Sales Manager in 1954 and who later became Vice-President of Marketing in 1959." During the period 1956–60, sales increased from $6.2 million to $9.1 million and the company's earned surplus increased from $187,000 to $351,000.

Mr. W. F. Goodwin, (honorary) executive vice-president, died in 1955, and Mr. Frank Carter, chairman of the board, died in 1958. Neither of these men had been active in company management for many years preceding his death.

In August, 1955, Mr. William F. Carter, Jr., son of the company's president and a graduate of Princeton University and The University of Texas, became assistant to the president. While serving in this capacity and later as treasurer (effective 1956), he streamlined the company's office setup and helped to introduce an effective budgeting and cost control system. In 1959, William F. Carter, Jr., was made treasurer and assistant general manager. About that time, and while the company was participating in the construction of its new Georgia plant, Mr. Martin A. Cannon—a technical and managerial specialist with considerable experience in the meat-packing industry—joined Superior Foods, Inc., to head up its production department and to take the lead in product research and methods improvement. Early success at this assignment earned for Mr. Cannon the title of vice-president for production in August, 1959. (Exhibit 2.)

Altogether the decade of the 1950's proved to be a highly successful period for Superior Foods, Inc.—a period when company sales more than doubled, productive capacity was tripled, employment increased from approximately 150 to 220 persons, and corporate earned surplus rose about 190 percent. (Exhibit 3.)

Products and Markets

Until the close of World War II, Superior's product line consisted of five food items: chili with beans, chili without beans, tamales, beans, and chili powder. In 1941 the company began to gradually add other food specialties (for example, beef stew, spaghetti and meat balls, enchilades, lima beans and ham, hot dog and barbecue sauces, corned beef hash, Brunswick stew, and sliced beef with gravy).

All of Superior's products except its chili powder were packed in four can sizes: 8-ounce, 15-ounce, 24-ounce, and 6¾-pounds. The 8-ounce and 6¾-pound sizes were introduced in 1959, primarily for sale under another brand name to schools, hospitals, lunch counters, vending machines, and other institutional outlets throughout the southern half of the United States. Nearly all of Superior's 1960 production was distributed through food brokers to wholesale grocers, chain stores, co-ops, the U.S. Armed Forces and one or two exporters (Exhibit 4). Approximately half of Superior's 1960 sales came from items not produced prior to World War II (Exhibit 5).

Superior's products were marketed in widely scattered areas throughout the United States until 1953, at which time the firm decided that freight and other distribution expenses on shipments to distant markets made sales in those localities unprofitable. According to a sales department representative:

> In our list price, we had included an average freight cost of about 50 cents per case, but freight (including warehousing costs) figured 75 cents or more. It appeared that we were losing—not even showing good management—by doing business in these far away territories. We even thought we might adopt zone pricing, but this would have put us out of line competitively. So we withdrew from our distant markets for the time being and adopted the policy of concentrating our sales efforts close to home, particularly in and around the state of Texas.

EXHIBIT 2

ORGANIZATION CHART

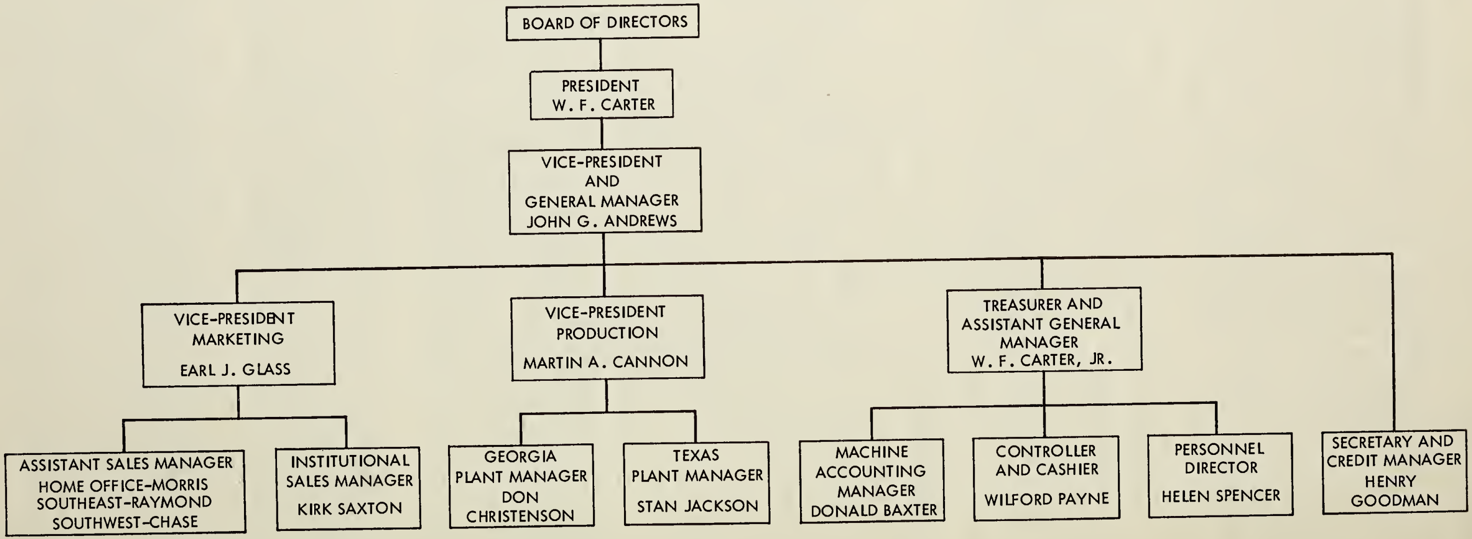
BOARD OF DIRECTORS
PRESIDENT W. F. CARTER
VICE-PRESIDENT AND GENERAL MANAGER JOHN G. ANDREWS
VICE-PRESIDENT MARKETING EARL J. GLASS
VICE-PRESIDENT PRODUCTION MARTIN A. CANNON
TREASURER AND ASSISTANT GENERAL MANAGER W. F. CARTER, JR.
SECRETARY AND CREDIT MANAGER HENRY GOODMAN
ASSISTANT SALES MANAGER HOME OFFICE-MORRIS SOUTHEAST-RAYMOND SOUTHWEST-CHASE
INSTITUTIONAL SALES MANAGER KIRK SAXTON
GEORGIA PLANT MANAGER DON CHRISTENSON
TEXAS PLANT MANAGER STAN JACKSON
MACHINE ACCOUNTING MANAGER DONALD BAXTER
CONTROLLER AND CASHIER WILFORD PAYNE
PERSONNEL DIRECTOR HELEN SPENCER

EXHIBIT 3

SUPERIOR FOODS, INC.
Comparative Balance Sheets
As of June 30, 1950, 1955, and 1960

ASSETS	*1950*	*1955*	*1960*
Current			
Cash	$ 17,158	$ 66,819	$ 52,541
Accounts receivable	127,488	209,920	317,073
Inventories	558,323	592,849	875,162
Other	12,427	30,112	24,387
	$ 715,396	$ 899,699	$1,269,163
Permanent			
Texas			
Land and building	$ 149,022	$ 198,886	$ 202,140
Machinery	139,482	347,399	492,447
Autos and trucks	101,292	138,852	113,101
Furniture and fixtures	22,301	49,067	86,376
Georgia			
Machinery	...	...	210,688
Furniture and fixtures	...	...	3,473
	$ 412,097	$ 734,204	$1,108,225
Less: Reserve for depreciation	100,698	267,374	522,177
	$ 311,399	$ 466,830	$ 586,048
Prepaid expenses and deferred charges	6,318	33,955	165,954
	$1,033,113	$1,400,484	$2,021,165
LIABILITIES			
Current			
Notes payable	$ 195,000	$ 375,000	$ 343,720
Accounts payable	40,736	54,752	91,647
Accrued expenses	12,532	41,014	58,788
Reserve for taxes	39,074	19,352	5,960
Long-term			
Mortgage payable	...	...	334,000
Notes payable	...	...	3,943
Total Liabilities	$ 287,342	$ 490,118	$ 838,058
NET WORTH			
Capital stock—Outstanding	$ 625,000	$ 725,000	$ 866,240
Less: Treasury stock	...	1,580	33,900
	625,000	723,420	832,340
Earned surplus	120,771	186,946	350,767
	745,771	910,366	1,183,107
	$1,033,113	$1,400,484	$2,021,165

By way of further explanation, Mr. William F. Carter, Jr., president, stated:

> . . . Our base of profitable territories was too small to commit any advertising in these outlying areas, so that the volume we had became harder and harder to maintain, and warehousing costs steadily rose both in absolute terms, and even more as a percentage of sales.

As a result of Superior's retrenchment policy, annual sales of approximately $265,000 in the Pacific Northwest, the Intermountain Region, the

EXHIBIT 4

Location of Brokers and Warehouses

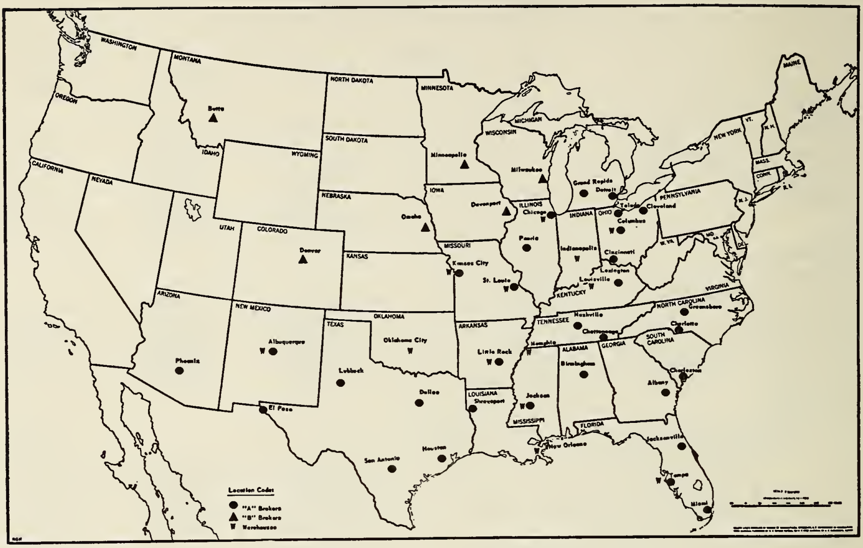

EXHIBIT 5

Sales Dollar
1956 to 1960

Product	*Percent of Total Sales* 1956	1957	1958	1959	1960
Where it came from:					
Beef Stew	29.3	29.5	29.1	27.7	27.1
Chili without beans	18.7	18.6	20.7	20.6	16.6
Chili with beans	16.6	17.3	17.4	15.8	19.9
Spaghetti and meat balls	12.3	12.9	10.5	16.2	11.4
Supreme chili powder	9.3	8.4	8.1	7.6	8.2
Tamales	6.8	6.6	7.1	6.4	8.4
All other	7.0	6.7	7.1	5.7	8.4
Where it went:					
Meat	28.8	29.8	36.5	36.0	36.5
All other raw materials	29.2	29.7	24.1	24.1	24.1
Selling and advertising	13.7	14.7	14.0	18.2	18.5
Payroll and profit sharing	10.5	9.6	9.2	7.7	8.2
Freight and warehousing	8.6	8.5	6.8	6.0	5.5
All other expenses	5.9	6.0	6.4	5.8	7.2
Earnings before income tax	3.3	1.7	3.0	2.2	. . .

North Central States, and the New England States were relinquished in 1953 in favor of the Southwestern and Southeastern markets—that is, with the exception of filling some unsolicited orders received from patronizing customers in these distant markets.

Industry

The meat-packing industry (including both fresh and canned meats) was intensely competitive at the national, regional, and local levels. Over the years, Superior Foods, Inc., had come to have more and more competitors, ranging from some of the giants of the food business to a diminishing number of small, independent local canners that catered to a limited, loyal, and usually price-conscious market. Normally, the giant companies had one of the lowest profit rates of all classes of trade.

The prices of Superior products were determined largely by the pricing practices of a half-dozen large national manufacturers; however, Superior Foods, Inc., had several items, amounting to over one third of its total sales volume, which were regional in appeal and, therefore, less subject to national competition.[1]

Selling Organization

Superior's customers (that is, wholesale grocers, chain stores, co-ops, the U.S. Armed Forces, and a few exporters) were contacted by 39 Superior brokers scattered throughout much of the United States (Exhibit 4).[2] Of this number, 33 were class "A" brokers and 6 were class "B" brokers. The former sold Superior's full product line, while the latter . . . being located in outlying market territories . . . handled for the most part only Superior's Supreme Chili Powder—a product for which there seemed to be no suitable substitute after Superior withdrew in 1953 from distribution areas north of New Mexico, Oklahoma, Missouri, and the Ohio Valley.

Both classes of brokers sold orders to buyers at the wholesale level, backed by orders secured at the retail level. Occasionally, class "A" brokers promoted pool-truck (quantity) shipments, passing the freight savings on to Superior customers.[3] Also, these same class "A" brokers carried on in-store or general promotional programs supported by Superior advertising schedules and buying allowances.[4] For their services, Class "A" brokers received 5 percent of all invoice sales covering shipments going into their respective territories, notwithstanding the point of sale or the location of the customer's buying office. The brokerage fee actually was slightly higher in "B" territories except for military sales.

---

[1] Some firms in the meat-packing industry operated at lower cost than others due to such advantages as lower freight rates, more astute buying of fresh domestic and foreign meats, a better balanced product line, more loyal customers and consumers, better and more efficient production, more economical channels of distribution, more effective utilization of company resources, and related factors.

[2] Use of salesmen by wholesale customers declined in the 1950's. Chains generally stocked their stores on the basis of consumer movement, or special promotions decreed by divisional headquarters—or by top headquarters, in the case of a small chain.

Co-ops supplied their members by means of order forms filled out by member retailers, and much the same procedure was followed by stores sponsored by a particular wholesaler, or by participating in special orders taken by a wholesaler. The main use of salesmen by wholesalers was to compete for the business of an independent retailer, and this class of retailer diminished almost 50 percent from 1948 to 1958—according to the Federal Trade Commission.

[3] Superior's policy on buying allowances, in line with industry practice, was to pay its customers the difference between the cost of Superior products on hand in

Superior followed a uniform national pricing policy, quoting the same price to all customers except those located in "B" territories and in certain distant military territories where added freight costs necessitated higher zone prices. No quantity discounts were granted, but customers were authorized to deduct from their remittances, where applicable, freight-saving allowances resulting from large quantity purchases.[5]

About 24 percent of all customer orders received by Superior Foods, Inc., in 1960 weighed 22,000 pounds or more, indicating considerable customer interest in freight savings. As a result, Superior was able to reduce its use of public warehouses in 1960 from a total of 35 to 22. Public warehouses were used for distributive purposes and to supplement the storage capacity of the two company-operated warehouses in Texas and Georgia during peak inventory periods.

Prior to 1956, Superior had seven divisional sales managers covering its widely scattered sales territories, and under them were 40 brokers and 33 direct salesmen. Approximately one third of these salesmen had been added to Superior's selling force during the Korean War for the purpose of developing the company's home market. As Mr. John G. Andrews, vice-president and general manager, explained: "For the first 40 years we had scant sales in Texas. At Phoenix, Los Angeles, St. Louis, Birmingham, and other distant points—yes; but not in Texas." In a matter of about three years, from 1953 to 1956, annual sales in the Southwest market increased by almost 20 percent. Then in 1956, the company adopted a straight brokerage plan. The reasoning behind this decision was summarized by Mr. John G. Andrews as follows:

> Our own direct salesmen were pretty well confined to the Southwest with the brokers operating in the other territories. Change in buying habits cut down on the time our salesmen had, both at wholesale and retail levels. As it now stands, Monday is a rather bad day to see a buyer, Friday is also a bad day; so it limits calls at the direct level largely to Tuesday, Wednesday, and Thursday.

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their warehouses and any price reduction offered with a promotional deal. This was known as floor stock protection, and was designed to protect those who had bought heavily beforehand.

[4] Theoretically, at least, for example, it makes no difference whether a company sets a list price for a certain product at $9.00 per case and offers no allowances, or sets a price of $10.00 per case and then rebates a dollar to the customers to cover services performed.

[5] On shipments to Superior customers, in the Southwest, freight breaks occurred at 22,000 and 36,000 pounds. In certain other areas, freight breaks occurred at 8,000, 15,000, 20,000, 22,000, 25,000, 30,000, and 36,000 pounds.

> At a retail level where our men previously did many things in the way of store merchandising, arranging stock, obtaining the greatest number of frontages that they could, etc.—these activities by and large cease on Thursday noon. Additionally, the retail grocery business has gone more and more into national chain setup and large sectional chains, and in many cases salesmen are not permitted to solicit orders or rearrange stock. . . . So our direct salesmen were having to come in on Friday without much incentive to get out until Tuesday morning. So "start up" and "closing" costs each week were beginning to grow and then we began looking at brokers as a means of selling our merchandise and we found that we could obtain brokerage companies that had very good retail setups. They were operating pretty well at local level, could slip in and slip out of retail stores and perhaps get to know the managers better than our direct retail men who of necessity had to limit their calls to intervals of six weeks. Brokers may, on either one product or another that they represent, be in every three weeks. Some special cases, every week. But the point that I'm trying to bring out is that retail salesmen for the brokers were on a little more personal relationship with the stock clerks or assistant managers, and although I don't know it officially, I suppose they do stretch that rule on working over shelf space wherever they can. At least, there is evidence of that as I get out in the trade myself.

In territories previously covered by Superior salesmen, selling expenses had ranged from slightly less than 5 percent to more than 12 percent of net sales. By adopting a straight brokerage plan in 1956, Mr. William F. Carter, Jr., pointed out: ". . . we saved, on an average, 2 percent of net sales. Of course, in some territories the total savings might have been 3 or 4 percent."

About a year before changing over to a straight brokerage operation, Superior Foods, Inc., designated three of its seven divisional sales managers to serve as assistant sales managers, and a fourth became a Superior broker in the Southwest. Replacements for these four men were named; and, of the seven men serving as divisional sales managers in early 1956, five formed two new brokerages and one joined an established Superior broker. The seventh man joined another firm. Several of Superior's brokers, in turn, hired a number of the 33 salesmen released from their jobs with Superior Foods, Inc., in 1956.

One of the new assistant sales managers, with the aid of an assistant regional sales manager, supervised brokerage activities in Houston, Shreveport, Little Rock, Memphis, Evansville, and points east. A second assistant sales manager called on brokers in St. Louis, Kansas City, Oklahoma City, Dallas, San Antonio, and points west. These men checked to see that brokers were carrying out in-store promotion and keeping abreast of Superior's advertising and sales programs. The third assistant sales manager served in the general office aiding the vice-president of marketing. In 1958, an institutional sales manager was added to Superior's selling organization to concentrate on sales to schools, hospitals, factories, private and governmental institutions, and the like.

Referring to the selection of brokers, Mr. Earl J. Glass, vice-president of marketing, explained:

> . . . Superior has tried to be one of each broker's top three accounts. One sure way of assuring a broker's interest and enthusiasm is to have him depend on Superior for a good part of his income. Needless to say, we do this to receive adequate attention on each and every call.
>
> There isn't a year that goes by we don't have to make a change in brokers. Sometimes it is just a case of getting fat and letting down. Sometimes it is a change in the structure of the market. For example, when chains move in, some brokers lose out (because buying headquarters and warehouses for these chains oftentimes are located in some other broker's territory).

A majority of the regional packers of canned-meat products operated under a brokerage setup while most all of the national packers used their own salesmen. According to Mr. John G. Andrews, vice-president and general manager, ". . . I think the reason is that they have a longer line of merchandise, more diversified. Where you have diversification, possibly it would work out mathematically that you can operate with salesmen cheaper than you can with brokers."

Advertising and Sales Promotion

Superior spent 5 percent more on advertising and promotional allowances in 1960 than in 1959, or 14 percent of sales in 1960 as compared with 13 percent in 1959. Most of the advertising and promotion funds were spent in the Southwest. However, percentage-wise more was spent in 1960 in the Southeast than previously. Advertising and sales promotional work presented a number of challenges to the sales department. Reportedly, most every customer had a strong desire for a deal that was better than his competitor's. Also, most every customer responded differently to various forms of promotion. A deal barely strong enough to interest one customer was oftentimes twice as strong as that needed to gain the cooperation of another.

Production

The Texas factory housed four production lines capable of producing three different products simultaneously. Two of these production lines could each turn out in an 8-hour day 2,700 cases or more of 15-ounce or 24-ounce cans. A third line, or 8-ounce line, had a capacity of about 1,500 cases daily; and a fourth line could pack about 500 cases of 6¾-pound cans in an 8-hour period. At the Georgia factory, there was a single production line comparable to the two 15-ounce or 24-ounce lines in Texas. Potentially, lower output costs were attainable at the Georgia plant because of its improved layout—including space, boiler capacity, refrigeration, and so on to take care of two additional production lines when needed.

Both plants operated on a one-shift basis (Exhibit 6). Mr. Andrews, vice-president and general manager, stated:

> On a short-term basis, use of a second shift at Texas, might have been more desirable than acquiring another plant. In fact, 3 shifts are more desirable

> than two. We could have gone that route, but we felt that over the next five years, we would probably get both plants in a position of [operating on] a 2-shift basis. . . . Furthermore, we're going to need a little more flexibility to develop our product line. We are at a standstill at this [Texas] plant to take on more new items and particularly to use can sizes which might be different from those we are now using.

Certain items such as tamales, enchiladas, and chili powder were produced only at the Texas factory. Installation of duplicate production equipment in Georgia was not contemplated by Superior until such time as full utilization could be made of existing equipment in Texas. For example, Watson's Supreme chili powder seasoning was bottled at the Texas factory in 1-ounce, 2-ounce, 30-ounce, and 5-pound sizes on a special completely automatic line having a daily capacity of 140,000 bottles. During 1960, this line (set up as a separate department) operated at approximately 70 percent of capacity.

EXHIBIT 6

MONTHLY PLANT PRODUCTION FISCAL YEARS 1956 TO 1960 INCLUSIVE
(Shown as Percent of Plant Capacity)

Month	*1956*	*1957*	*1958*	*1959*	*1960*	
	Texas	*Texas*	*Texas*	*Texas*	*Texas*	*Georgia*
July	58%	53%	59%	66%	76%	
August	104	100	127	116	112	23%
September	103	122	102	167	80	55
October	109	128	139	131	77	56
November	114	137	128	93	72	32
December	78	75	77	76	50	28
January	106	115	132	130	77	30
February	100	92	105	85	58	38
March	72	102	63	73	49	30
April	66	76	68	66	31	22
May	73	70	82	81	50	20
June	91	100	58	79	40	29

Overtime was a major production cost factor, according to Mr. Martin A. Cannon, vice-president for production.

> . . . we have to bring people in early in the morning to get the lines set up so that when the main gang comes in, we have everything ready to go. Then at the end of the production period, we have to clean up the plant. So a certain number of these people have to remain and do this work. Therefore, we run quite a bit of overtime. When you break it down on a case basis, I think it costs us about 2 cents a case. . . . We are working to reduce this overtime.

In 1960, Superior employed some 170 persons at its factory, general offices, and warehouses in Texas, and another 50 people at its Georgia plant. Superior's business was not considered sufficiently large by its management to merit the employment of a full-time food technologist or quality control man. Consequently, the purchasing department was held responsible for the quality of ingredients, and the factory foremen were held responsible for product quality. Every foreman had a procedure or recipe book to follow. To insure product quality, daily samples of runs were taken from the production line for inspection the following day in Superior's test kitchen. Still other daily samples were taken and tested by a government inspector representing the Meat Inspection Division of the U.S. Department of Agriculture.

Superior operated a test kitchen at its Texas factory where testing, new formula development, and modification of old formulas were carried out. Because competitors could pretty well tell what went into any given product, there were few items in the industry unmatched by competition. Members of Superior's top management and factory management met weekly to sample selected products, test new formulas, or decide on product improvements. Recognizing that taste preferences of people living in different parts of the country do vary somewhat, there were occasions when a consumer testing agency was employed to conduct consumer preference surveys.

Prior to the construction of the Georgia plant, Superior found it necessary to build up large annual inventories in preparation for peak seasonal demands. In spite of this safeguard, as Mr. Martin A. Cannon pointed out:

> . . . we would sometimes get 10–20 carloads behind in our shipments. Orders often were 7–10 days late in being filled. Of course, that isn't good. Right now we have more production facilities than we actually need to meet our shipping demand. We hope that in the next couple of years our sales demand will take up the slack.

Finance

For many years short-term bank loans of $200,000 to $300,000 were used by Superior Foods, Inc., to help finance current operations. However, in December, 1959, the firm obtained a 12-year, 5½ percent loan of $400,000 from a Texas life insurance company. These funds were used to free the business from peak-season indebtedness and to provide nearly $300,000 in fixed assets at the Georgia plant.

Of Superior's 43,312 shares of outstanding common stock, the Carter family owned about 40 percent. The next largest shareholder was an estate holding approximately 2,000 shares. The remainder was owned by some 210 company employees, brokers, and friends of the Carter family.

There was no stock option plan for company executives, but key executives could borrow funds from Superior at a nominal interest rate with which to buy up to 270 shares of common stock. The policy of the company was to peg its stock at $20 per share—that is, to buy back any stock for sale at $20 per share. Nominal cash dividends were paid quarterly until 1960, but most of the company's earnings were left in the business to help finance its growth. Occasional stock dividends were paid in lieu of cash.

Administration

The election of officers and directors and the ratification of corporate actions were always conducted by the board of directors on a unanimous basis. In 1960, the board of directors consisted of Mr. William F. Carter, president; Mr. John G. Andrews, vice-president and general manager; Mr. William F. Carter, Jr., treasurer and assistant general manager; Mr. Henry Goodman, secretary and credit manager; and three outstanding Texas residents—a lawyer, a dairy products executive, and a structural materials consultant. In speaking of the board, Mr. William F. Carter, president, commented:

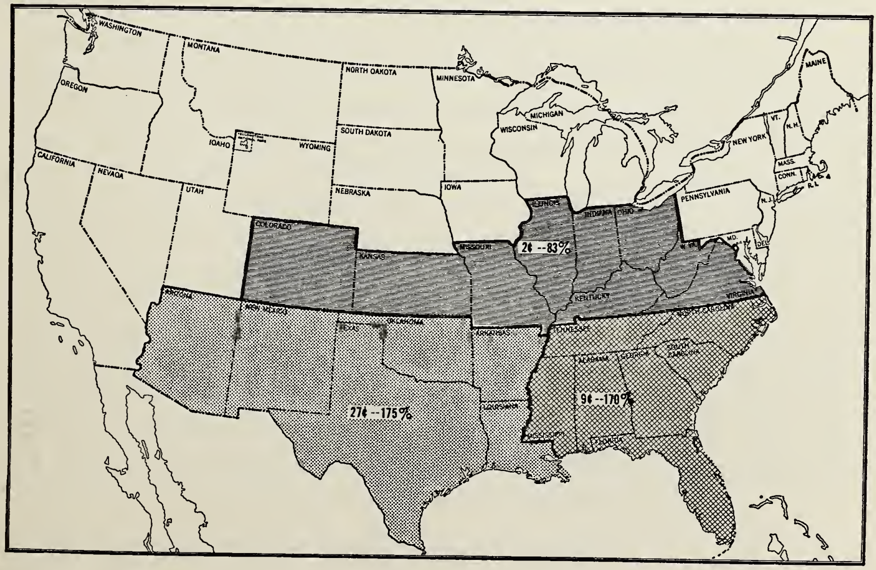
> Our Board of Directors are working people. They take a real interest in problems, and they are a real help. I like a *working* board. We meet monthly, and there is 100 percent attendance at nearly every meeting. The Board makes the major decisions, whereas the Executive Committee formulates plans only.

In the interest of providing some specific guides to future operation, Superior's board of directors formulated in 1958 the following set of "long-range projects":

1. The possibility of making and/or selling various new items and sizes, whether closely related to our present line or not.
2. The possibility of producing or having produced certain of our requirements locally in areas difficult to reach economically from Texas.
3. The possibility of reducing our short-term borrowing requirements through longer-term arrangements.

EXHIBIT 7

1960 Per Capita Sales by Regions and 1960 Regional Sales as Percent of 1955



4. The question of priority and degree for the intensive development of various Superior markets and products, present and future.
5. The question of developing a large staff to meet future needs and to create future growth.

Significant strides in each of the above five fields were considered by Superior's top management to be the key to making the two-plant operation a success and to laying the foundation for further company expansion in the future.

*The Baha Petroleum Corporation**

In July, 1961, John Kasch, executive vice-president of the Baha Petroleum Corporation, called four members of his staff together to discuss a problem that had been disturbing him for some time. In view of recent developments in the petroleum industry, he felt the company should attempt to predict (1) the structure and nature of the LPG (Liquid Petroleum Gas) market 10 years from now, (2) what transportation mix would be most effective 10 or 20 years from now in distributing LPG, and (3) how these two questions would affect the long-range plans of the company.

HISTORY

Early Development

John Kasch was executive vice-president of one of the successful medium-sized petroleum companies in the United States. The company had been founded in 1922 by Mr. Harold Webster, who had put together an idea and $300. This initial step was the predecessor of the present multimillion dollar Baha Petroleum Corporation. In 1922 in a city overrun with oil brokers who handled anything that would pay them a commission, Webster decided to be a specialist. His policy was to handle nothing but gasoline and to act as a simple clearinghouse for manufacturers and purchasers. He developed this idea with great vigor and success.

The history of the company from that day to this has been one of progress. There were times in the early days when current assets were overshadowed by current liabilities, but when the books were audited at the end of each succeding year, the company never failed to show a profit. Mr. Webster commented, "Progress, in retrospect, often appears to be along a steady trend, but actually it more often is the result of a series of forward-looking undertakings. The progress of Baha Petroleum Corporation is no exception."

In 1924 the company negotiated the first of its contracts to assure a definite volume of natural gasoline each month, which it could, in turn, offer to its customers on a firm basis. One of the steps which contributed to the progress of the company was the acceptance by other producers of the fact that Webster was not a broker but was a manufacturers' sales representative. On that basis, sound business relationships were established and have existed without interruption to the present time.

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* Prepared by Ike H. Harrison, Texas Christian University.

Since the early days when a specified amount of natural gasoline was contracted from a definite source, Baha Petroleum Corporation has grown until today it purchases more products from more plants on a long term, take-or-pay-for contract than any other handler of the products of natural gas plants.

Transportation

The officers soon realized that without their own transportation facilities, they were handicapped in their ability to guarantee specified quantities to their customers over extended periods. Accordingly in 1925, they bought 30 cars, the first of the present large fleet of natural gasoline tank cars.

Due to the fact that Baha was diversified—they had a wide variety of products in many locales—the company was able to deliver promptly many types of products. This was one of the forces that encouraged the large-scale producers of products of natural gasoline plants to make long-term, quantity contracts with Baha for both present and future deliveries.

One of the most important upward surges for the company occurred in the middle 1930's. In 1935, by acquiring seven natural gasoline plants and the 75 or 80 natural gasoline department personnel of a gasoline manufacturing corporation, the company became a full-fledged manufacturer. Thus, they became a manufacturer, transporter, and marketer of natural gas.

Storage

An equally important step was the decision to undertake large-scale storage of natural gasoline during periods of slack demand so that the product would be available in periods when demand exceeded current production. The company accordingly erected, on the Texas Gulf Coast, the first of a series of 100,000 barrel Horton spheroids. That huge tank was the first of its type ever constructed to hold liquids under pressure.

Before large-scale storage was undertaken, the industry each year experienced a feast and a famine. Heaviest demand came during the winter months, and that demand was so much greater than current production that the wild bidding for product zoomed the prices out of all proportion. In the summer months, when production normally was greater, demand was lightest, but the plants had to keep operating. They could not be shut down until demand picked up. The result was a period each year when the manufacturers were all but drowning in product with no place to move it. Price was no factor. Distress sales were everyday occurrences, and offers to sell at almost any price that would move the surplus caused the general market structure to be woefully weak.

The first large storage tank did not help a great deal, but Baha felt they were on the right track, so they soon ordered additional tanks constructed. It was not long, therefore, until Baha through their storage facilities was in a position to absorb a major portion of the gasoline for which there was no market.

This method of marketing brought a great sense of security to manufacturers with whom the company dealt. They knew that, within limits, what the current market could not absorb would be moved to storage, and they would get paid for their production at reasonable price levels.

The storage plan brought an equal measure of security to large-scale buyers of natural gasoline. They came to realize that, in periods of heaviest demand when current production was not sufficient, there was a backlog of product in storage against which they could draw.

Mr. Webster remarked. "There is no doubt that this initial large-scale storage program, a program which was so sound that other companies later adopted it, contributed as much if not more to the present stability of the natural gasoline industry than probably any other one development."

Development of the LPG Market

The Baha Petroleum Corporation became interested in the possibilities of the liquefied petroleum gas markets in the early stages of development of the products. The corporation, in 1935, sold about 50,000 gallons of a butane-propane mixture. That started the company on its way, although for a few years it was a relatively small way.

By 1940, however, the corporation was very active in the liquefied petroleum gas industry. It was natural that such a development should occur, for the corporation already had its sales organization set up and was handling the natural gasoline from many of the plants where manufacturers were beginning to extract the lighter hydrocarbons which formerly they had wasted, because of a lack of outlet.

As Baha got deeper and deeper into the liquefied petroleum gas business, the executives realized that the corporation needed their own transportation facilities for LPG. Late in the 1930's, therefore, the executives purchased the first of what eventually became one of the largest fleets of high pressure tank cars in the country.

In the early part of 1940 the corporation became interested in the marketing possibilities of iso-butane. The war was on in Europe, and this country was manufacturing large quantities of aviation fuel for countries who later became our Allies.

During the war the corporation became one of the nation's largest independent and nonintegrated manufacturers, marketers, and transporters of iso-butane, normal butane, and propane.

Thus, the Baha Corporation experienced almost a mushroom growth during the war years, and as Mr. Webster pointed out, "Our growth was based on a sound foundation of experience. We accomplished it without one cent of assistance from the government."

Postwar Expansion

In 1945 it was decided to offer a portion of the stock to the public and get the stock listed on the New York Stock Exchange. The initial offering was well oversubscribed before the stock was made available.

Then, in May, 1946, came the progressive step that placed Baha Petroleum Corporation in the 20 to 30 million dollar corporation group, and made it one of the leaders in the industry. That step was the purchase of a large petroleum company, consisting of natural gasoline plants, pipelines, transportation facilities, large-scale storage facilities at tidewater, and oil production.

In February, 1948, the company expanded further by acquiring another substantial oil company.

To facilitate this distribution of LPG, in October, 1948, the company acquired all the stock of a large bottled gas distributing company.

The Company Today

Through these developments since 1922, the corporation had become a fully integrated company. Today Baha is engaged in manufacturing, transporting, and marketing at wholesale natural gasoline; in manufacturing, transporting, and marketing at wholesale and retail liquefied petroleum gas; and in producing and selling crude oil and natural gas. The company is also engaged in manufacturing and marketing special products and certain petrochemicals, the transportation of petroleum by pipeline, and the sale of residue gas. The company receives mileage and rental income for the use of its tank cars and for portions of its marine transportation facilities in periods of seasonal light demand of LP-Gas. Oil and gas production has expanded and now its manufacturing, marketing, and oil and gas operations are estimated to be of approximately equal importance.

The company is one of the large manufacturers of and marketers of natural gasoline and LP-Gas. It is estimated that the two top distributors of LP-Gas account for 26 percent of the total volume. This company is one of the two top companies.

The company had property of a gross book value of $172,516,102 as of December 31, 1955, with depreciation, amortization, and depletion reserves of $65,376,395. The net book value of property was $107,239,707 classified by departments as follows: gasoline plants and refining, 27 percent; developed and producing oil and gas leaseholds, 31 percent; storage terminals, tank ships and barges, 17 percent; underdeveloped and nonproducing leases, 10 percent; tank cars, 7 percent; land, 2 percent; miscellaneous, 5 percent; pipeline and equipment, 1 percent. The company received certificates of necessity with respect to property additions aggregating approximately $29,550,000, of which approximately $25,580,000 had been expended as of June 30, 1955. Of this amount, 56 percent was expended for acquisition of tank cars and marine transportation. The certificates permitted an average of 63.2 percent of the cost to be amortized over a five-year period in computing taxable net income. Of the total certified for rapid amortization, 43.44 percent had been depreciated for income tax purposes as of June 30, 1955. An application for a certificate of necessity was approved for the 400 LP-Gas cars delivered in 1957 at a cost of about $4,400,000. The current financial condition is proportional to this statement.

Transportation Inventory

The company is in a good competitive position by virtue of its control, through ownership and lease, of special-type pressure tank cars, an ocean-going propane-butane tank ship, a fleet of propane-butane barges for use on inland waterways and intercoastal canals and for seagoing service, marine storage and distributing terminals and inland storage facilities at several strategically located points.

The company owns and operates adequate gathering, residue and other gas pipelines located in the general vicinity of and serving its plants, as well as some short-run common carrier pipe line systems.

On October 31, 1955, the company operated a fleet of 4,144 railroad tank cars consisting of 159 natural gasoline cars owned and 1,092 leased under equipment trust arrangements; 1,393 LP-Gas owned and 1,451 leased under equipment trust arrangements; and 49 LP-Gas cars leased from a tank car company. Four hundred additional tank cars were delivered in 1957 at a cost of approximately $4,400,000. In 1960 the fleet consisted of 4,351 cars.

The company owns an ocean-going propane-butane tankship with a pressure tank capacity of 34,000 barrels of butane or 32,600 barrels of propane. The company owns three propane barges and leases under equipment trust arrangements one butane barge and two propane barges, having a combined capacity of 59,000 barrels. Another propane barge of 10,000 barrel capacity was recently completed.

The company owns tidewater facilities for cargo assembling and storing LP-Gas at several places on the Gulf Coast and on the East Coast. Underground and above-ground storage units are located strategically throughout the Gulf Coast and the Midwest. The combined capacity of these LP-Gas terminals and storage facilities was approximately 1,800,000 barrels in 1955. By 1960 this had been expanded many times with new underground storage units of 1,000,000 capacity being developed for early future use. The 3,000,000 storage capacity for LP-Gas can be more easily visualized as 100 trains, each a mile long and made up exclusively of tank cars—or as a fleet of 20,000 average sized trailer transport trucks. The storage terminals located on the Gulf Coast make storage and supply services available to Gulf Coast refining and chemical industries. Cargoes picked up at these terminals are consigned to coastwise and foreign ports.

To service the large fleet of tank cars—some 3,000 LP-Gas cars—the company maintains a tank car repair shop. This shop has room for 40 cars under roof, 30 cars in the yard. The shop can paint and repair more than 100 in a month. It can handle any job from minor repair to major reconstruction. While this fleet of tank cars is primarily intended to serve the transportation requirements of the LP-Gas and Natural Gasoline marketing because these requirements are of a highly seasonal nature, and because of increased product movements in trucks and pipelines, a tank car leasing program designed to maintain maximum fleet utilization has been successful. These pressure cars are ideally suited to the transportation requirements of the petro-chemical industry—particularly ammonia hydroxide. Cars under long-term lease are sometimes painted to conform to the lessee's standards of design and color.

While the company has long been a leader in owning the facilities for transporting its products, it has never owned trucks. While tank cars and barges were acquired by the company, trucks were leased. Historically, oil companies have not owned fleets of trucks—probably because the return on investment is so much lower than the return on exploration, which has the depletion allowance as an additional reward for successful location of production.

Another reason given for this is that the long haul back is not profitable unless the truck is loaded. The company was not able to provide a cargo for the round trip. Another reason given was the myriad of details concerned with maintaining and servicing trucks. Trucks represent a much smaller investment than a fleet of tank cars, and therefore there have always been independent truckers who were anxious for the business of transporting LP-Gas and natural gasoline.

Change in Transportation Policy

Late in 1959 the company was ordered to divest itself of a number of properties, including the complete fleet of tank cars. The Federal Trade Commission in a news story dated January 7, 1960, stated: "Properties to be sold include all rail tank cars used in transporting either LP-gas or natural gasoline which the company owned or had the right to use as of March 2, 1956. The rail fleet is the largest of its kind in the country." The order stipulated that none of these properties may be sold to any of the 23 major companies dealing in natural gas liquids. The company had this statement to make in the same article: "We have tried this case before an examiner of the Federal Trade Commission for more than two years, and in our opinion, during this time no evidence of a violation of the antitrust act has been established. Nevertheless, we have consented to this settlement in order that we could finally bring this matter to a conclusion."

Meeting of the Long-Range Planning Committee

John Kasch was interrupted in his thoughts by his secretary who reminded him that the Long-Range Planning Committee would be meeting in his office in 10 minutes.

As he thumbed through the committee folder which she had brought him, he read again the last line in the article from Barron's, "The future of the industry is limited only by the imagination of its leaders."

He glanced at a memo from the manufacturer of the new jumbo tank cars, which indicated that the 30,000 gallon car would cost only about twice as much as the 11,000 gallon cars. He studied a memo from one of his staff members suggesting that it might be feasible to request special tariffs for train loads of tank cars for LPG.

As he regarded all of the variables in the LPG picture, he wondered whether this was a problem that might be programmed on data processing equipment.

EXHIBIT 1

TRANSPORT STATISTICS IN THE UNITED STATES, 1959
Rolling Stock Owned at Close of Year
Confined to Owners of 1,000 Cars or More

Company	*Petroleum Tank Cars*
General American Transportation Co.	51,092
Union Tank Car Company	48,098
North American Car Corporation	5,572
Baha Petroleum Corporation	4,351
Oil company A	1,821
Oil company B	1,468
Oil company C	1,246
Oil company D	1,232
Oil company E	1,100

EXHIBIT 2

SUMMARY OF SELECTED DATA BY INDIVIDUAL PRIVATE CAR OWNERS CONFINED TO OWNERS OF 1,000 CARS OR MORE

	Investment in Transportation Property				*Operating Expenses*			
	Car or Protective Service Property	*Recorded Depreciation and Amortization*	*Investment Less Depreciation and Amortization*	*Operating Revenues (Total Revenues)*	*Car Service*	*General*	*Total Expenses*	*Taxes*
General American Transportation Corp.	$343,005,245	$129,878,463	$213,126,782	$101,186,959	$58,821,776	$ 7,061,774	$65,883,550	$14,272,049
Union Tank Car Co.	260,470,356	103,748,218	156,722,138	98,748,506	20,592,345	60,555,712	81,148,057	7,957,915
North American Car Corp.	73,570,974	30,567,014	43,003,960	17,210,618	7,852,055	1,377,596	9,229,651	3,882,246
Baha Petroleum Corp.	36,396,092	11,366,648	25,029,444	5,222,702	2,374,698	358,780	2,733,478	123,484
Oil company A	3,570,975	3,439,304	131,671	793,084	678,281	...	678,281	...
Oil company B	3,464,739	3,341,749	122,990	798,091	441,224	77,741	550,177	11,113
Oil company C	7,243,591	4,882,232	2,361,359	1,473,176	812,830	22,580	835,410	42,668
Oil company D	2,963,927	2,891,940	71,987	881,338	496,628	115,086	611,714	...
Oil company E	2,146,921	1,739,310	407,611	683,465	377,318	...	377,313	10,504

Source: *Transportation Statistics of United States*, 1959.

EXHIBIT 3

RELATIVE IMPORTANCE OF TWO CLASSES OF PRIVATE CAR OWNERS

Item	*Persons Owning 1,000 Cars or More*	*Persons Owning 100 but Less than 1,000 Cars*	*Total*
Number of owners represented	30	82	112
Investment in transportation property	$1,657,411,992	$140,240,152	$1,797,652,144
Reserve for depreciation	679,481,854	74,691,483	754,173,337
Investment in transportation property less reserve for depreciation	977,930,138	65,548,669	1,043,478,807
Operating revenues—Total	407,550,395	35,918,882	443,469,277
Operating expenses—Total	285,522,260	41,280,875	326,803,135
Taxes	40,577,832	...	40,577,832
Equipment owned at close of year:			
Refrigerator cars	86,714	2,821	89,535
Tank cars—Petroleum	117,011	9,059	126,070
Tank cars—Other	15,145	14,396	29,541
Stock cars	2,140	...	2,140
Other cars	52,531	4,510	57,041
Total cars	273,541	30,786	304,327
Mileage made by owned cars during year:			
Refrigerator cars	3,003,709,608	89,583,649	3,093,293,257
Tank cars—Petroleum	1,617,166,819	167,221,791	1,784,388,610
Tank cars—Other	216,805,701	174,017,551	390,823,252
Stock cars	11,375,376	...	11,375,376
Other cars	262,281,677	66,058,760	328,340,437
Total mileage	5,111,339,181	496,881,751	5,608,220,932

Source: Transport Statistics in the United States, for the year ending December 31, 1959, Part 9, Private Car Lines, Prepared by the Bureau of Transport Economics and Statistics, Interstate Commerce Commission, Washington, D.C., 1960.

EXHIBIT 4

SALIENT STATISTICS OF THE NATURAL-GAS-LIQUIDS INDUSTRY IN THE UNITED STATES, 1955–59
(Thousand Gallons)

	1955	*1956*	*1957*	*1958*	*1959*
Production					
Natural gasoline and isopentane	4,457,079	4,438,890	4,499,495	4,355,025	4,222,266
LP-gases and ethane	5,072,698	6,487,413	6,655,282	6,783,000	7,874,706
Finished gasoline and naphtha	823,103	832,915	779,807	701,456	660,666
Other products	564,722	535,295	455,005	539,977	714,170
Total	10,917,602	12,294,513	12,389,589	12,379,458	13,471,808
Shipments for use in gasoline[1]	7,059,737	6,990,389	7,241,831	6,904,179	7,067,963
Transfers to nongasoline uses					
LP-gases and ethane	4,549,681	4,796,743	4,915,211	5,174,140	6,149,430
Other products	220,107	207,768	181,011	191,077	158,708
Stocks at plants, terminals, and refineries					
Natural gasoline	165,799	194,757	168,244	198,284	170,058
LP-gases	300,129	587,094	568,601	664,705	790,579
Other products	103,775	81,627	109,727	92,595	84,606
Total	569,703	863,478	846,572	955,584	1,045,243
Value of natural gas liquids at plants, thousand dollars	619,006	697,143	679,456	689,710	758,496
Average value per gallon, cents	5.2	5.7	5.5	5.6	5.6
Natural gas processed, million cubic feet	8,185,953	8,590,163	8,378,561	8,452,544	9,186,862
Average yield, all natural gas liquids gallons per cubic feet	1.44	1.43	1.44	1.46	1.47
Sales for fuel and chemical uses					
Liquefied petroleum gas and ethane	4,227,711	4,528,356	4,780,141	5,054,271	6,047,061
Liquefied refinery gas and ethane	1,768,772	2,107,407	2,158,980	2,407,818	2,872,100
Total	5,996,483	6,635,763	6,939,121	7,462,089	8,919,161
Exports of natural gasoline, LP-gases	183,155	187,882	192,505	120,017	94,620

EXHIBIT 5

Stocks of LP-Gas Liquids in the United States 1955–58 and 1959, by Months, in Thousand Gallons

	LP-Gases	
Date	*At Plants and Terminals*	*At Refineries*
December 31		
1955	281,649	18,480
1956	560,928	26,166
1957	605,249	22,596
1957*	546,005	22,596
1958	634,885	29,820
1959		
January 31	424,635	29,946
February 28	386,655	33,222
March 31	471,595	31,668
April 30	620,563	18,186†
May 31	807,524	17,472
June 30	920,999	18,690
July 31	1,008,677	18,312
August 31	1,054,111	17,976
September 30	1,097,410	19,740
October 31	1,062,374	20,958
November 30	942,852	26,040
December 31	767,143	23,436

* New basis: To eliminate nonrecoverable stock of LP-gas in underground storage.

† Decrease from last month's stock figure due mainly to the exclusion of underground stocks of LP-gas at refineries. Such stocks are now included in the figures for stocks at plants and terminals.

EXHIBIT 6

Sales of LP-Gas* and Ethane in the United States 1955–59, by Types, in Thousand Gallons

Year	*Ethane*	*Percent of Total*	*Propane*	*Percent of Total*	*Butane*	*Percent of Total*	*Iso-butane*	*Percent of Total*
1955	†	...	3,260,571	53.3	724,334	11.8	‡	...
1956	†	...	3,626,189	54.6	888,545	13.4	36,088	0.5
1957	†	...	4,009,144	57.8	1,117,748	16.1	26,721	0.4
1958	†	...	4,247,373	56.9	1,119,544	15.0	25,805	0.3
1959	783,789	8.8	5,132,194	57.5	1,298,487	14.6	11,086	0.1

Year	*Butane-propane Mixtures*	*Percent of Total*	*All Other Mixtures*	*Percent of Total*	*Total LP-Gas and Ethane*	*Total Percent*
1955	1,428,938	23.3	708,875	11.6	6,122,718	100.0
1956	1,160,017	17.5	924,924	14.0	6,635,763	100.0
1957	934,183	13.5	851,325	12.2	6,939,121	100.0
1958	1,050,086	14.1	1,019,281	13.7	7,462,089	100.0
1959	1,143,284	12.8	550,321	6.2	8,919,161	100.0

* Data include LP-gases but exclude LP-gases blended into gasoline.

† Not reported separately before 1959.

‡ Not reported separately before 1956.

EXHIBIT 7

SALES OF LP-GASES* AND ETHANE IN THE UNITED STATES, 1955–59, BY USE, IN THOUSAND GALLONS

Year	*Domestic and Commercial*	*Internal Com-bustion*	*Industrial*	*Refinery Fuel*	*Gas Manu-facturing*	*Chemical*	*Synthetic Rubber*	*Synthetic Secondary Recovery of Petroleum*	*All Other*	*Total*
1955	2,801,379	651,821	423,431	101,033	213,760	1,493,177	406,210	†	31,907	6,122,718
1956	3,001,021	773,471	438,916	142,590	212,293	1,600,604	418,101	†	48,767	6,635,763
1957	3,067,070	805,056	441,474	122,405	231,155	1,732,338	418,189	68,557	52,877	6,939,121
1958	3,293,677	852,387	492,862	179,231	238,911	1,898,862	371,961	68,981	65,217	7,462,089
1959	3,934,792	889,698	439,200	136,830	182,903	2,525,910	513,941	231,134	64,753	8,919,161

* Data include LP-gases but exclude LP-gases blended into gasoline.

† Not reported separately before 1957.

EXHIBIT 8

THE BAHA PETROLEUM CORPORATION
Consolidated Balance Sheet
June 30, 1955

ASSETS

Current assets	
Cash in banks and on hand	$ 17,655,900
U.S. government securities, at cost which approximates market	50,000
Notes and accounts receivable (less reserve for doubtful items, $54,691)	
Trade	
Notes	695,017
Accounts	7,969,836
Affiliates	431,695
Officers and employees	24,652
Other	77,323
Inventories	
Natural gasoline and LP-gas products	4,344,086
Merchandise	742,943
Materials and supplies	3,290,847
Prepaid expenses	335,993
Total Current Assets	$ 35,618,292
Investments—At cost	
Other security investments	$ 449,044
Notes and accounts receivable due after one year	803,046
Total Investments	$ 1,252,090
Property, plant, and equipment—At cost*	
Gasoline plants	$ 45,028,106
Transportation, storage, and distribution facilities	39,419,692
Developed oil and gas reserves	62,480,741
Undeveloped oil and gas leaseholds and royalties	10,182,071
Construction in progress	4,916,198
Other property	7,253,131
Total	$169,279,939
Less reserves for depreciation and depletion*	62,145,340
Property, plant, and equipment—Less reserves	$107,134,599
Tank cars and barges in use under lease†	
Portion offset by deferred rental obligations (see contra)	$ 16,304,662
Corporation's equity (before amortization)	5,901,616
Total	$ 22,206,278
Less reserve for amortization	2,609,902
Tank cars and barges in use under lease—Less amortization	$ 19,596,376
Patents—At nominal value	$ 1
Deferred charges	
Unamortized debt expense	$ 127,721
Other	191,521
Total Deferred Charges	$ 319,242
Total	$163,920,600

EXHIBIT 8—*Continued*

LIABILITIES

Current liabilities	
Notes payable	
Banks	$ 3,029,793
Stockholder of subsidiary	100,000
Other	7,000
Accounts payable	
Trade	8,845,388
Affiliates (paid in July, 1955)	2,500,000
Accrued liabilities	
Federal and state taxes on income	1,921,379
Other taxes	251,044
Dividends payable	...
Tank car rentals†	315,274
Other	630,105
Customers' deposits	216,338
Total Current Liabilities	$ 17,816,321
Deferred income from sale of production payments, and so on	$ 1,074,768
Long-term debt—Notes payable due after one year	
Banks	$ 36,400,000
Other*	10,077,000
Total Long-Term Debt	$ 46,477,000
Reserve for ship and barge inspection and related costs	$ 105,495
Deferred rental obligations under lease of tank cars and barges (see contra)†	$ 16,304,662
Provision for deferred income taxes	$ 1,900,000
Minority interests in subsidiaries (capital stock of $104,467 and surplus of $691,326 at June 30)	$ 795,793
Capital stock and surplus	
Capital stock	
Preferred—Authorized, 200,000 shares of $100 par value each; none issued.	
Common—Authorized, 3,000,000 shares of $3 par value each; issued and outstanding, 1,887,325 shares; stated value	$ 6,013,145
Surplus	
Capital	14,835,142
Earned	58,598,274
Total Capital Stock and Surplus	$ 79,446,561
Total	$163,920,600

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* Properties and depreciation and depletion policy:

It is the policy of the Corporation to capitalize lease bonus costs and delay rentals on undeveloped oil and gas leaseholds and intangible drilling and development costs of producing wells. Capitalized costs of undeveloped oil and gas leaseholds are not amortized but are recovered through depletion charges, if the leaseholds become productive or are charged against income as the leaseholds are surrendered or expire.

Depreciation is based on cost and the estimated useful life of the properties (after deducting allowance for estimated salvage value where applicable). The rates (or other bases) used in computing the annual amounts are generally as follows:

Gasoline plants	Estimated remaining life of individual plants; where plants are fully depreciated a 10% rate is applied to current additions.
Tank cars	28-year life.
Maritime equipment	4% on tanker and 30-year life on barges.
Pipe lines and equipment	5% and 10%.
Natural gasoline storage terminals	6⅔% to 10% or terms of leases covering sites of facilities.

LP-Gas distributing stations and storage facilities	3% to 10% or terms of leases covering sites of facilities.
LP-Gas cylinders	10%.
Leasehold equipment	Unit-of-recovery method, except 10% on general equipment.
Other property	5% to 33⅓%.

Depletion of developed leaseholds and development costs is based on the unit-of-recovery method.

Maintenance and repairs are charged to operations as incurred. Replacements and betterments are charged property accounts.

The policy with respect to the adjustment of accumulated reserves at the time properties are retired or otherwise disposed of, except in the case of disposals of complete units of property, is to charge such reserves with difference between the investment and salvage values; in the case of disposals of complete units of property investment and the related accumulated reserves are cleared from the accounts and any profits or losses are taken into income.

Included in other property is a parcel of land costing $1,215,522 pledged for payment of the deferred balance of the purchase price of $900,000 with no liability for deficiency to the Corporation. This deferred liability is included in the balance sheet as other long-term debt.

† Leased tank cars and barges and related deferred rental obligations:

The Corporation has created a series of equipment trusts authorizing the issuance of trust certificates, the proceeds from which have been used for the purchase of tank cars and barges. Simultaneously with the creation of the trusts, lease agreements were executed between the Corporation and the Trustees whereby such tank cars and barges were leased to the Corporation in consideration of its agreement to pay quarterly, as rentals for the cars and barges, sufficient amounts to enable the Trustees to pay the quarterly instalments of the trust certificates (treated by the Corporation as its equity in the leased equipment), dividends (treated as interest by the Corporation), and certain incidental expenses. Title to the tank cars and barges automatically vests in the Corporation upon the payment of all rentals due under each of the respective leases. The Corporation is charging to operations currently the amortization of its ultimate cost of the leased tank cars and barges over 28 years and 30 years, respectively, after allowance for salvage.

At June 30, 1955, the Corporation held, under the leases above described, tank cars and barges acquired by the Trustees from the proceeds of the issuance of trust certificates in the aggregate amount of $22,206,278. The certificates outstanding (exclusive of monthly accruals included in current liabilities) aggregated $16,304,662 at June 30, 1955. The certificates mature quarterly over periods of from ten to fifteen years from dates of issue and bear annual interest rates of from 3½% to 4¼%. At present quarterly instalments approximate $398,000.

The aggregate amounts of maturities of deferred rental obligations in each of the five years following the balance sheet dates (including monthly accruals in current liabilities of $315,274 at June 30, 1955) are:

Year	*June 30, 1955*
First	$1,592,765
Second	1,592,765
Third	1,592,765
Fourth	1,397,150
Fifth	1,262,765

EXHIBIT 9

THE BAHA PETROLEUM CORPORATION
Extract from Comparative Consolidated Income Account
Years Ending June 30
(Net Sales Millions)

Year	*Natural Gasoline*	*Residue Gas*	*LPG Products*	*Merchandise*	*Tank Car Income*	*Crude Oil and Gas*	*Refinery Products*	*Total Sales and Revenues*
1947	32.1	0.5	11.0	0.4	0.6	2.9	0.2	47.7
1948	49.8	0.6	23.1	0.3	0.9	5.3	0.5	80.5
1949	54.7	0.8	26.6	1.0	1.5	5.8	0.4	90.8
1950	36.1	1.0	17.9	1.7	1.8	5.1	...	63.6
1951	44.1	1.1	27.9	3.1	2.1	6.4	...	84.7
1952	49.4	1.2	36.7	3.0	2.9	10.2	...	103.4
1953	52.1	2.6	41.4	3.1	4.1	12.1	...	115.4
1954	46.2	3.6	41.3	3.2	4.2	14.2	...	112.7
1955	42.2	4.2	38.8	3.2	4.2	17.4	...	110.0

APPENDIX A

Glowing Future:

Declining Costs, Rising Demand Spark Expansion of Liquefied Gas

by Lawrence A. Armour*

. . . In recent years pipe lines have played an increasingly important part in the distribution of LPG. The case in point is the 2,000 mile pipe line which goes from the southwest into the Minnesota-Illinois-Iowa area. Mr. Robert E. Thomas, president of Mid-America Pipe Line Company, stated, "The Mid-America Pipe Line promises to cut the cost of bringing the LP-gas to market by upwards to 50%, thereby putting pressure on the rate charge by other means of transportation." At the same time heavy production runs of petro-chemical feed stocks and other sources of LPG have cut the base costs of the fuel itself. Meanwhile, demand which has climbed to new highs for 40 straight years continues to spurt. Steady increase in existing uses, coupled with vigorous expansion into new fields, has given the industry a built-in element of growth. Beyond that, of most other fuels these days, the future of LPG appears to glow with promise.

Mr. Thomas, in April, 1961, made this statement, "In 1960, sales of LPG were 9.86 billion gallons, which advanced 10.5% since 1959, and nearly 300% from the total consumed as recently as 1950."

. . . There are several large producers of LPG who also distribute the product at retail through subordinate divisions. In addition to the major producers, there are some 20,000 independent distributors who round out the field.

Many new improved types of storage facilities had been developed for LPG. Prior to 1950 the industry could rely on only one means of storing propane, namely, above ground tanks. Today in contrast, thanks to technological progress, LP-gas is kept in washed out salt domes and in mined out shale, granite, and limestone caverns. All told, the industry now boasts underground storage capacity for about 2,280 million gallons of LP-gas, or the equivalent of roughly one-fifth the annual retail sales. On a dollar and cents basis, the underground facilities have far-reaching significance. For one thing, initial costs are low, averaging roughly $2 a barrel for salt domes compared to $25 a barrel for above-ground tanks. Then, too, upkeep in maintenance costs for underground facilities are relatively modest. Most important, the distributors are now able to fill their caverns in the slow summer months when the wholesale prices are down, and draw on reserves to satisfy the demands of high cost winter months.

The fuel that has powered these companies to almost uninterrupted gains is interesting, versatile and fairly abundant. The term "LP-gas" is generic, referring to a family of light hydrocarbons, the most common of which are propane and butane. Roughly 25% of these gases is produced in refineries, where they are drawn off a step or two before the high octane gasoline fractions. The other 75% comes from natural gas, which, in most cases, is a "wet" commodity rich in petroleum liquids.

As a fuel, LP-gases have a good deal to recommend them. For one thing, they offer all the advantages of natural gas, namely, cleanliness, efficiency and dependability. In addition, they are high in BTU values, burning with roughly three times the heat of natural gas and six times that of manufactured gas. Finally, since they can be liquefied by a moderate amount of pressure, then changed back to a vapor simply by reducing the pressure, they combine the compactness and portability of a liquid with the advantages of a gas.

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* Copyright 1961, *Barron's*, April 3, 1961. Barron's Publishing Co., Inc.

To millions of homeowners living beyond the reach of city gas mains, these are no small blessings. For them, LP-gas—which is stored on their property in either cylinders or underground tanks—heats their houses, cooks their food, dries their clothes and performs allied services. Roughly 45% of the country's LP-gas winds up in the home, the industry's largest and one of its fastest growing markets.

The farmer is another major consumer. On the farm LP-gas is used to dry grain, cure tobacco, power tractors and irrigation pumps, and heat barns, incubators, and greenhouses. One of the fastest-growing uses of LP-gas in agriculture is weed burning, a feat accomplished either by a portable cylinder and torch, or by a power device equipped with burning heads. Not only do LP-gas flames cut easily between the rows, leaving the crops untouched, but also the destroyed weeds add important fertilizing values to the soil.

LP-gas also is catching on fast in industry, where it already has displaced large amounts of motor fuel. Its advantages here are manifold. Cheaper than gasoline in most parts of the country, it also is a money-saver in terms of engine wear, for it burns completely and cleanly, leaving no soot or gummy residue. As far back as 1912, one of the industry's pioneers drove an LP-gas powered vehicle up New York's Broadway. Today some 50% of the country's tractors are factory-built to burn LP-gas. The percentage runs about the same for fork-lift trucks and other in-plant vehicles, while buses, trucks and taxis rapidly are moving in the same direction. As for passenger cars, many already have been converted and, with air-pollution becoming an ever-growing headache, there is little doubt that many more will be swinging over to clean-burning LP-gas in the near future.

Passenger cars, for that matter, are just one of the large potential consumers of the future. Swimming pools are heated these days by LP-gas engine-driven and absorption devices; patios are lighted by LP-gas lanterns; outdoor stadiums and drive-in movies are turning to LP-gas heaters. Nor is the end anywhere in sight. "It seems that just about every day someone comes up with a new use for LP-gas," says one distributor. "In the meantime, our old customers keep increasing their consumption at a nice, steady pace."

From the point of view of demand, then, the distributors of LP-gas are doing fine. At the same time, they have been making considerable progress toward solving some long-standing problems of supply. To begin with the business always has been highly competitive. Since capital requirements are low, hundreds of "one man-and-a-truck" operations have sprung up. While the multiplicity of outlets has helped spur the use of the fuel, it also has led to price-cutting and whittling of profit margins.

During the past five or six years, however, competitive pressures have eased. Recognizing the merits of large-scale operation, virtually all the distributors have expanded by means of acquisition.

Significant progress, meanwhile, has been made toward solving the industry's biggest headache—high transportation costs. On the West Coast, where supplies are located nearby, this factor never has been too compelling. In the East, contrariwise, transportation costs historically have accounted for two-thirds of the retail price of LP-gas. Proximity to the producing fields is one of the big reasons why West Coast distributors consistently have outperformed their Eastern and Midwestern counterparts.

On this score, the pipeline companies lately have given the latter a major assist. Texas Eastern Transmission's Little Big Inch, a common carrier line which a few years ago added LP-gas to its traffic, has helped lower transportation costs. The Mid-America Pipe Line, which has been on stream only four months, is doing the same thing. According to Robert E. Thomas, Mid-America's president, the line's charge for hauling a barrel of LP-gas from the Texas fields to St. Paul is only 80 cents, compared with a railroad rate of over twice as much. Comparable savings are available to other terminal cities in Kansas, Nebraska, and neighboring states.

The rails, to be sure, have not accepted the prospective loss of business meekly. Deciding to fight fire with fire, they have been replacing their old 10,000 gallon cars with units boasting capacities of 18,500, 22,000, and 30,000 gallons. Owing to the economies yielded by the jumbos, the carriers now are offering reductions of up to 45% of their former freight charges.

To the distributors, especially those located in the East, each decline in transportation costs is money in the bank and the promise of more. "In Texas and Oklahoma," says one East Coast retailer, "LP-gas is used for everything, simply because it's available and cheap. But in the East, we've been frozen out of a lot of markets because we sell a high-cost product. If we can get our prices down to a competitive level, we're going to find ourselves a flock of new customers."

Moreover, possibilities of reducing costs further look promising. The distributors themselves, through investments in larger, more efficient delivery trucks and in high-speed loading and unloading equipment, are moving ahead at their end. The pipeline companies, meanwhile, keep pushing further and further out. At the moment, plans are afoot to extend the Little Big Inch into New York State; to build a new line from Houston to the Carolinas; and to link Alberta and Chicago by yet another new line.

All in all, the future of LP-gas seems bright. On the one hand, the distributors' operating costs are being slashed steadily by the relentless advance of technology. On the other, their product, already an integral part of the American scene, is finding new adherents almost daily. Mark Anton, president of Suburban Propane, nicely sums up the story when he says: "The future of the industry is limited only by the imagination of its leaders."

APPENDIX B

HISTORY OF UNION TANK CAR COMPANY*

Union Tank Car Company, owner and lessor of the world's largest fleet of railroad tank cars, was incorporated in 1891, succeeding to a business which began soon after the first commercial oil well began operating in 1859.

As one of the major car line operators serving the petroleum industry, Union Tank Car has shared extensively in the growth of that industry. The company in recent years has also become a leading builder and lessor of tank cars for handling other types of bulk liquid products, including chemicals, liquid fertilizers, coal tar products, vegetable oils, liquid petroleum gas, ammonia, acids, and liquid oxygen.

A pioneer in the development of the tank car, the company has contributed many engineering and mechanical innovations including the first all-steel car. More recently, Union Tank Car has introduced its HD ("Hot Dog") design tank car which eliminates both the underframe and dome of conventional tank cars, the first basic change in tank car design in the past 50 years.

The company has also been a leader in the trend toward larger tank cars, and has designed and built cars up to 30,000 gallons in capacity—the world's largest.

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* Source: News Release by Union Tank Car Company, Chicago, Illinois.

Union Tank Car owns and operates the nation's largest fleet of railroad tank cars (53,000). For inspection, repair, and maintenance of its fleet of tank cars, Union Tank Car maintains 11 major service centers in the United States and four in Canada, in addition to 8 minor repair points. The company has car-building plants at Philadelphia and Whiting, Indiana.

Through its divisions, Union Tank Car also is a leading fabricator in metals and offers a wide range of products and services for the storage, transportation, and treatment of liquids for industrial, community, and household use.

Refiners Transport & Terminal Corporation, Detroit, Michigan, provides tank truck transportation service for shippers of bulk products in the Midwest.

Graver Tank & Mfg. Co., East Chicago, Indiana, the builder of the Wood River geodesic dome, is a leading plate fabricator and erector of steel, nonferrous metal and alloy products, including storage tanks for municipal and industrial use and process vessels for the petroleum, chemical, power, nuclear and missile industries.

Products Tank Line of Canada, Ltd., owns and operates the largest railway tank car fleet in Canada. Its Sparling Tank & Mfg. division is a major Canadian fabricator and erector of storage tanks, pressure vessels, and other steel plate products.

Union Overseas provides the products and services of the other divisions of the company in major areas of the world, aided by a world-wide network of associated enterprises.

Getz Bros. & Co., one of the company's newest acquisitions, is one of the nation's largest import-export firms and has some 30 cities throughout the world. The company serves as general agents for leading airlines and shipping companies.

Along with its expanding operations, Union Tank Car's gross sales volume has increased from $34 million in 1956 to $115 million in 1960. The company has paid a dividend every year since 1914.

The Kennedy Oil Company[*]

If Thomas E. Kennedy[1] could walk today through the offices of the company which he founded 60 years ago, he would marvel at its far-flung growth and change. He would nod assent, no doubt, over its alertness to new policies which keep it filling the needs of a complex and constantly changing business world. With some interest, he would consider a recently proposed reorganization of certain accounting functions.

I. COMPANY HISTORY AND ORGANIZATION

The case of The Kennedy Oil Company goes back to 1891 when Thomas E. Kennedy, a former clothing store owner, began to acquire oil properties in Kellyville, Pennsylvania. His judgment proved good, and by 1900, his holdings were extensive enough to require the organization of a corporation, The Kennedy Oil Company. In 1901, Peoples Oil Company acquired a 60 percent interest in the company and later purchased the remaining 40 percent. The company remains today a wholly owned subsidiary of the Peoples Oil Company.

In the first decade of the century, The Kennedy Oil Company became a recognized leader in the development of oil and gas wells in Pennsylvania. In 1920, however, the company established a new southern division with headquarters in Dallas, Texas, and began to take an active part in the mid-continent area of oil operations. The company's activities in this area soon became so extensive and successful, that in 1925 its central headquarters were moved from Pennsylvania to Dallas, Texas, its present location.

During the next 10 years, operations in the mid-continent area were successful and the company continued to grow. The company expanded into Oklahoma and Kansas in 1929. In 1936, the company began to extend operations into the Illinois-Indiana-Kentucky Area, and later into the Arkansas and Louisiana Areas. The company, about this time, also became more active as a producer in Colorado and Wyoming.

In 1947, after nearly half a century of operating as a producing company, Kennedy Oil entered the manufacturing and marketing phase of the oil industry. It began with acquisition of the Choctaw Oil and Gas Company, which operated a refinery at Ardmore, Oklahoma, and a number of retail marketing outlets. From this beginning, the company expanded its marketing operations until it now has retail outlets in 10 states in the Midwest. It also has a 35,000 barrel-a-day refinery at Ardmore, Oklahoma, its manufacturing and marketing headquarters.

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[*] Prepared by Edward C. Burris, Oklahoma State University.

[1] All names have been disguised.

The Kennedy Oil Company is now a large organization. It operates in 21 states and employs 3,300 workers. Its plant and equipment is valued at more than $193 million, not counting oil and gas reserves. Kennedy presently has 4,500 oil and gas wells in production or capable of producing and owns leases in some 274,000 acres of producing property. It also holds leases on 5 million acres of underdeveloped acreage at various locations throughout the company's operating territory.

The administrative hub of The Kennedy Oil Company is its headquarters in Dallas where a seven-man board of directors is responsible for its overall activities. Production and exploration operations are organized into six geographical areas or divisions. The manufacturing and marketing headquarters are located in Ardmore, Oklahoma. Marketing operations are further divided into four regional divisions. An organization chart of the company is presented in Exhibit 1.

The company organization chart shows a good overall view of the administrative setup. It is now necessary to examine in further detail those parts of the organization which are involved in the reorganization proposal: the Raw Product Sales Department and the Accounting Department. Both are located in Dallas, Texas.

EXHIBIT 1

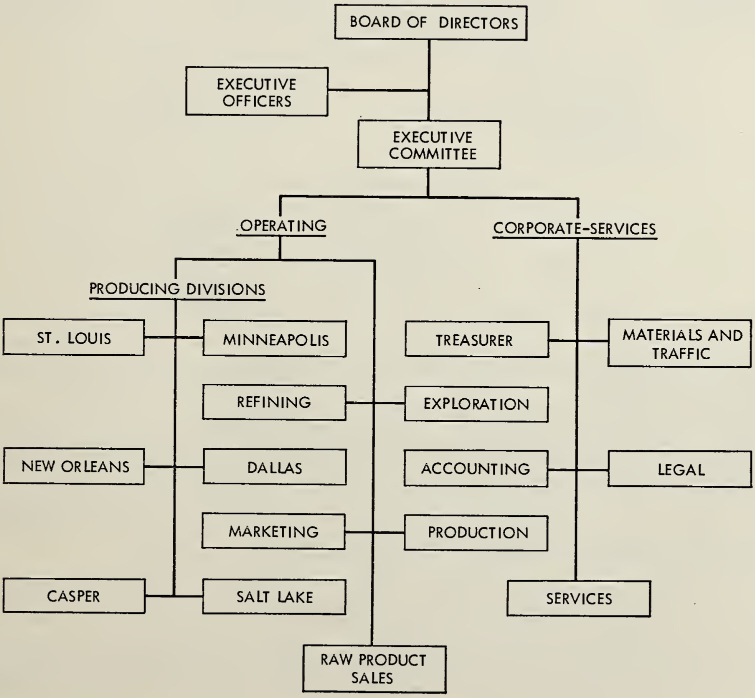
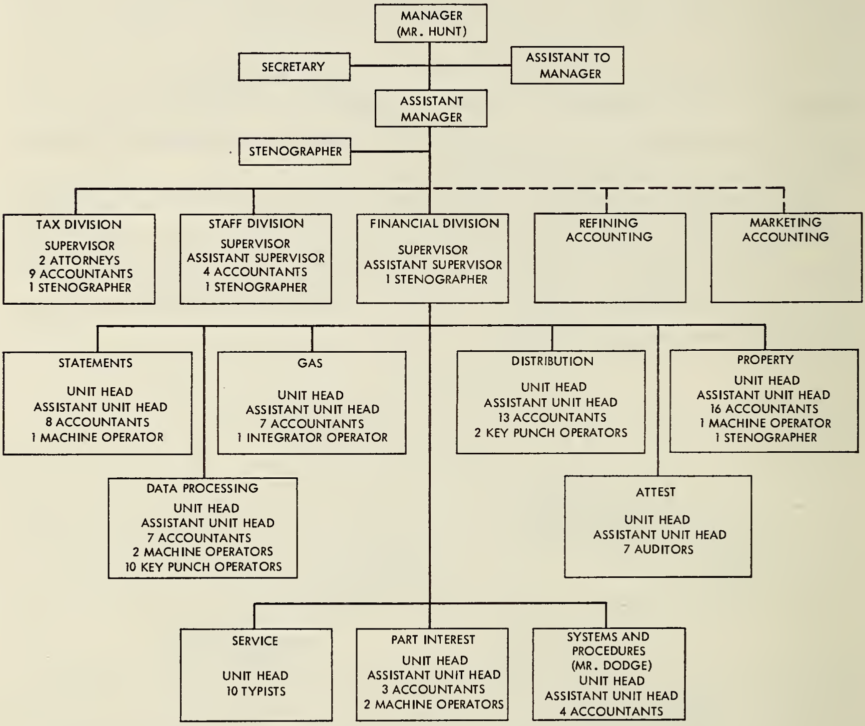


Exhibit 2 is an organization chart of the Accounting Department. It may be noted that the department consists of five divisions as functional groups. The manufacturing and marketing accounting is done at Ardmore, Oklahoma, and these divisions report administratively to their department managers in Ardmore. The principal responsibility of the Accounting Department to the Ardmore group is to lay down ground rules for the accounting work, and the local divisions are responsible for getting the job done.

EXHIBIT 2

Accounting Department
(Present)



Other than administratively, the Ardmore groups are quite similar to the Dallas Financial Division. All three groups are largely scorekeepers, handling vendors' invoices, payrolls, and so on. Both the marketing and Dallas offices have machine installations. The Dallas data processing unit is currently processing around 2 million cards per month.

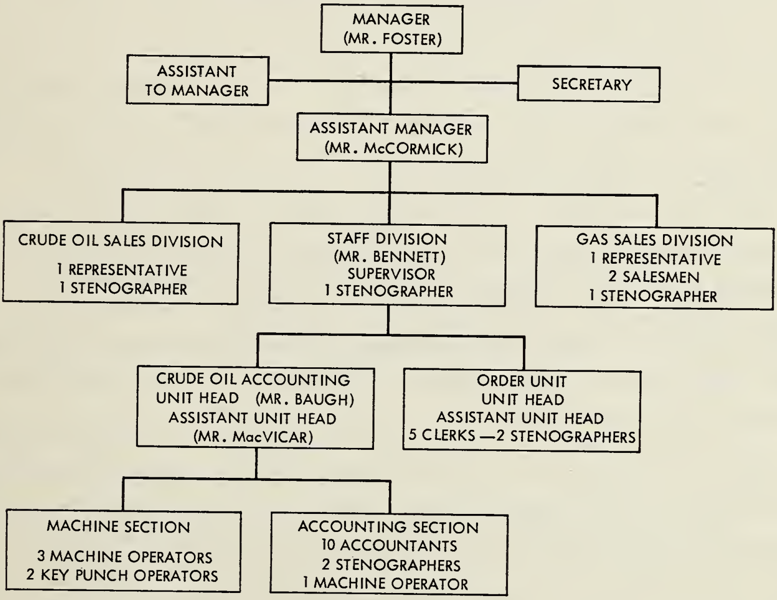
The Dallas Financial Division, with 115 people, is highly specialized, in that instruments and work of a specific nature are directed to and processed by a group or a unit as applicable. After the instruments are processed by the applicable unit, they are passed on to the data processing unit where all of the recordings are effected necessary for the flow into the profit and loss or balance sheet accounts. Almost all accounting work is done with machines.

The other two divisions in the Accounting Department are the Tax and Staff Divisions; but this case does not involve them, and reference to their functions will be omitted.

The Raw Product Sales Department is also involved in this case, especially the Crude Oil Accounting Unit of this department. An organization chart of the department is shown in Exhibit 3.

EXHIBIT 3

Raw Product Sales Department
(Present)



The Raw Product Sales Department is responsible for the wholesaling of all crude oil and natural gas produced by the company. The main functions of the Crude Oil Accounting Unit are to maintain records of crude oil produced and sold, to calculate division of interest and make payments to royalty and working interest owners, to maintain accounts receivable subsidiary ledgers for crude oil sales, and to prepare accounting vouchers.

Next are presented further details of the proposed reorganization plan.

II. THE BACKGROUND STUDY

The growth of the company has created new and more complicated problems for all departments, especially for those responsible for the clerical and accounting functions. Any increase in a company's sales, production, and employment invariably necessitates stronger controls over the collection and disbursement of company funds, more precision in record keeping, and improved techniques of written communication as well as general improvements on all administrative levels in order effectively to coordinate a larger organization.

As new problems appeared, a need for improvement in clerical and accounting procedures became evident. Many supervisors felt that some procedures needed to be simplified, some mechanized, and perhaps some eliminated. Others felt that the existing decentralization of certain responsibilities created undesirable inefficiencies. Mr. Robert Dodge, head of the Systems and Procedures Unit, felt that the possibility of centralizing all accounting and data processing under the Accounting Department should be investigated. This could be done, he felt, by a reorganization plan involving the following: (1) a transfer of the accounting section of the Crude Oil Accounting Unit from the Raw Product Sales Department to the Financial Division of the Accounting Department, (2) a transfer of the data processing section of the Crude Oil Accounting Unit from the Raw Product Sales Department to the Accounting Department.

Upon the suggestion of Mr. Dodge and Mr. Edward Hunt, head of the Accounting Department, a comprehensive study of clerical and accounting procedures was approved by the board of directors of the company. The purpose of the study was to investigate ways to improve the efficiency of all clerical and accounting procedures by work simplification, elimination, or mechanization. The study, however, focused on the reorganization mentioned above.

Mr. Dodge and two of his assistants were assigned to carry out the investigation. In addition, a representative from an outside systems firm (specializing in the designing and improving of accounting and clerical procedures), was asked to assist. The plan was to study in detail all procedures performed by the crude oil accounting unit to determine where improvements could be made. All employees of the unit were interviewed to discover exactly what functions each employee was performing, the procedures involved, and the time spent on each function. The following employees, constituting the accounting section of the Crude Oil Accounting Unit, were interviewed:

Unit head	1
Assistant unit head	1
Stenographers	2
Accountants	10
Machine operator	1
Total	15

The machine section of the Crude Oil Accounting Unit was also under study, and its employees were interviewed. This section consists of the following:

Machine operators	3
Key punch operators	2
Total	5

Exhibit 3 shows the organization of the Crude Oil Accounting Unit within the Raw Product Sales Department.

The survey team had access to company job description sheets on which were detailed the duties of each employee. These sheets were compared with the activities of the employees according to their oral descriptions of their duties as related in the interviews. The surveyors, of course, made necessary observations in order to insure an accurate impression of the operations of the unit. Many discrepancies were found between the job description sheets and the actual performance of the employees. The surveyors felt that this indicated a lack of control in the unit.

It was found that individual employees had little knowledge of the overall operations of the unit. Many employees knew nothing about any accounting procedure other than those personally performed. When asked what happened to a certain form after leaving his desk, the typical employee answered: "I don't know." According to Mr. Dodge, most employees believed that the most important forms were the ones which went into their respective files.

The surveyors explained this lack of initiative in the following manner: The Crude Oil Accounting Unit had been isolated from other accounting departments for many years. The employees saw no chance for advancement or promotion. Most of them had been with the company for many years and had not grown with the other parts of the company. The average age of the employees in the department was 47.4 years; five men were in their 60's, five in their 50's.

After the preparation of functional flow charts and intensive study of the operations of the Crude Oil Accounting Unit, the surveyors were convinced that a reorganization would improve the overall efficiency of the company.

III. THE PROPOSAL

The following proposal was presented to the board of directors:

During the course of the study, we formed the opinion that various changes in the present organization would be beneficial. The changes that are being proposed should accomplish one or more of the following objectives:

1. Make better use of the available capacity of accounting machines and related operating personnel, by combining organizational units now separated.
2. Make more effective use of the staff responsible for improving clerical procedures which involve several departments, by giving this staff adequate organizational status.

3. Permit more direct communications between organizational segments.
4. Provide accounting supervisors and employees with greater opportunities to broaden their knowledge of various accounting operations.
5. Assign procedures of an accounting nature to the Accounting Department Manager's area of responsibilities and authority.

The four specific recommendations relating to organizational changes are discussed below.

A. *Transfer the Crude Oil Accounting Unit from the Raw Product Sales Department to the Financial Division of the Accounting Department:*

The main functions of the Crude Oil Accounting Unit are to maintain records of crude oil produced and sold, to calculate division of interest and make payment to royalty and working interest owners, to maintain accounts receivable subsidiary ledgers for crude oil sales, and to prepare accounting vouchers.

These are accounting functions, and should be transferred to the area of responsibility and authority of the Accounting Department Manager. This transfer would also be a preparatory step to the eventual consolidation of all accounting for production, involving crude oil and gas, gasoline products accounting, and to attendant reductions of administrative costs. Eventual consolidation of the two now separate, but similar, procedures for payment to royalty and working interest owners, permitting a single procedure flow subsequent to the division of interest, is another reason for such a change.

As part of the Financial Division of the Accounting Department, employees of the Crude Oil Accounting Unit could look forward to job rotation into tasks that would give them additional knowledge in other areas of accounting operations. Temporary imbalance in staff (due to vacations, illness, and the like) could be more easily coped with when the unit is part of the Accounting Department, by temporary transfers between units comprised of personnel with accounting knowledge.

B. *Merge the Crude Oil Accounting Machine Section into the Data Processing Unit of the Accounting Department:*

The Crude Oil Accounting Machine Section, as part of the Crude Oil Accounting Unit, is responsible primarily for calculating oil run tickets, computing division of interest, and preparing checks to royalty and working interest owners. Machine procedures involving oil run ticket calculation and division of interest are already done on the computer located in the Data Processing Unit of the Accounting Department. Remaining machine procedures are performed on the Crude Oil Accounting Machine Section's own machines. Also, before preparing checks to owners, this section combines its own cards, used to pay owners of interests in gas.

We believe that, by having the Data Processing Unit of the Accounting Department absorb the Crude Oil Accounting Machine Section's punched card machine installation, savings in personnel would be obtained. Also, $2,100 per year of equipment rental costs would be saved by returning to the supplier several machines made surplus by better use of productive capacities of the equipment. The remaining machines that would be transferred to the Data Processing Unit, the capacity of which would not be fully used for crude oil accounting functions, would provide additional machine capacity for the Data Processing Unit. Machine operators would learn to do other data processing routines, thus increasing the flexibility of the data processing staff.

C. *Change the status of the Systems and Procedures Unit to that of a division, reporting directly to the manager of the Accounting Department:*

The Systems and Procedures Unit serves the entire company in developing improvements in administrative procedures. In recent years, it has also worked closely with nonaccounting personnel in developing uses of data processing equipment for various work of the Exploration and Production Departments. The staff comprises individuals with accounting as well as technical backgrounds.

Efforts to improve administrative procedures tend to be most effective when they are based on a company-wide point of view, rather than on departmental or divisional objectives. As a matter of practicality, however, systems and procedures staffs usually report to an executive in the financial area, generally at the Accounting Department Manager's level. This should not preclude the systems staff from working to achieve maximum benefit to the entire company.

The concept of the Accounting Department Manager's responsibility for developing systems and procedures improvements in cooperation with other departments is expressed in the organizational manual. We believe this responsibility could be better discharged by giving the Systems and Procedures Unit divisional status, reporting directly to the Manager of the Accounting Department. Such an organizational change would also tend to permit selection and scheduling of systems review projects in the sequence of maximum benefit to the company.

D. *Give divisional status, within the Accounting Department, to the Data Processing Unit:*

The Data Processing Unit has experienced considerable growth during recent years, as a result of continuing efforts to mechanize not only accounting procedures, but also various data processing functions of other departments such as treasury, exploration, and production. A number of the newer technical applications have been made feasible through the acquisition of the computer; other technical applications are under study.

Annual salaries of the 24 employees of the Data Processing Unit (inclusive of fringe benefits at 13 percent of base salary) would amount to about $135,600 a year after our recommendations are installed. Annual costs of machine rental would amount to about $100,000.

The size, cost of personnel and machines, and complexity of many different applications for many areas of activity, including nonaccounting areas, lead us to believe that the Data Processing Unit should be given divisional status. The unit is too large to be effectively supervised by one unit head, even though he is presently furnished an assistant. We have recommended that division of supervisory functions within the unit also be undertaken.

Further details of the proposed reorganization were presented. The surveyors believed that if the accounting section of the Crude Oil Accounting Unit were transferred to the Accounting Department, the unit could be reduced to 11 employees instead of the 15 presently employed. The unit would then consist of:

Unit head	1
Assistant unit head	1
Accountants	8
Machine operator	1
Total	11

The following jobs would be eliminated:

Stenographers	2
Accountants	2
Total	4

The surveyors defended their position in the following manner: (1) the stenographers would no longer be needed, since the unit would have access to the stenographic pool in the Accounting Department and much of the statistical typing work could be eliminated. The remainder could be done by machines in the Accounting Department. (2) Flow charts made by the surveyors indicate that the unit's work can be done with two less accountants if proper procedures are followed. (3) The gas products unit of the Accounting Department does work of similar nature and volume. There are only 10 employees in this unit, whereas the reorganization would leave 11 in the Crude Oil Accounting Unit.

The surveyors argued further that the machine work now performed in the Crude Oil Accounting Unit by 5 employees could be done by 3 persons if this function were transferred to the Data Processing Unit of the Accounting Department: Employees needed, if transfers were made, would be:

Machine operators	2
Key punch operator	1
Total	3

Jobs eliminated would be:

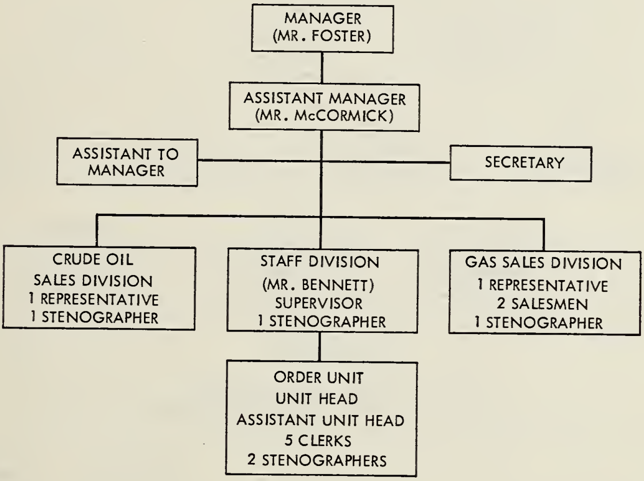
Machine operator	1
Key punch operator	1
Total	2

Besides the elimination of the two jobs, the surveyors felt that further savings of $2,100 annually could be effected by reducing machine rental costs.

The reduction in jobs was defended by arguing that the work now being done on machines in the Crude Oil Accounting Unit could be done with fewer men because this work would dovetail into the machine schedule of the data processing unit of the Accounting Department. In other words, if the transfer were made, existing machines could be used more effectively.

EXHIBIT 4

Raw Product Sales Department
(Proposed)



The other two proposals concerning the changing of status of the data processing and systems and procedures units were not discussed further by the surveyors. Exhibits 4 and 5 show the organization of the Raw Product Sales Department and the Accounting Department if the changes are approved. Exhibit 6 is a schedule of savings presented by Mr. Dodge and his survey team.

IV. OBJECTIONS TO THE PROPOSAL

After the survey team presented the case for reorganization, the board of directors directed that the report be studied by all interested parties, and established a date for another meeting at which time any objections to the proposals would be considered.

As would be expected, the major source of criticism of the report was the Raw Product Sales Department. If the reorganization were effected, this department would lose 20 of its 41 employees. Mr. Howard Foster,

EXHIBIT 5

ACCOUNTING DEPARTMENT
(Proposed)

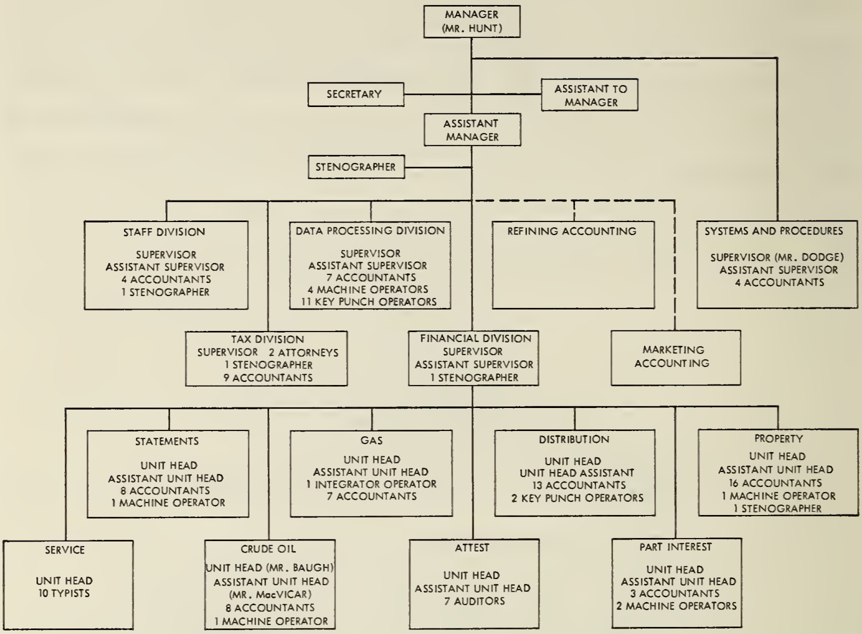


EXHIBIT 6

THE KENNEDY OIL COMPANY
Schedule of Estimated Annual Savings

		Number of Employees	*Total Annual Savings*
Personnel reduction:			
Raw Product Sales Department:			
Crude Oil Accounting Section........		4	$27,840*
Crude Oil Machine Section..........		2	13,920
Total..........................			$41,760
Machine rentals:			
Reduction...........................	$3,600		
Addition............................	1,500		2,100
Total annual savings..............			$43,860

* The annual salary used to compute the personnel savings is $6,960 per employee. This annual salary is comprised of the average gross earnings of the personnel involved plus 13 percent of this average for fringe benefits.

manager of the department, Mr. James McCormick, assistant manager, Mr. A. H. Bennett, staff supervisor, and Mr. Joe MacVicar, assistant unit head of the Crude Oil Accounting Unit, were the principal ones offering opposition. Mr. MacVicar has for some time been scheduled to succeed retiring Mr. Baugh as unit head of the Crude Oil Accounting Unit. These men were all considered good employees.

When the four met to prepare their case for presentation to the board, two of them seemed particularly worried over the impending merger.

"Accounting in Kennedy Oil has never been centralized," boomed Foster, the department manager. "Look at Marketing and Manufacturing. They have their own accounting units. Why pick on us?"

No one answered him directly. Each was busy with his own thoughts. Baugh, head of Crude Oil Accounting, stared mildly down at the conference table wondering if opposition were worth the effort. He'd been head for a long time now and had done a good job, he knew. But already he was grooming MacVicar to take over his work in another year when retirement reached him. MacVicar was a hard worker, seemed eager to learn, eager for more responsibility. It would be the younger man's disappointment, more than his, if their department were melted into a bigger unit. After some moments, Mr. Baugh addressed his assistant:

"*Joe,* let's hear from you. You've been thinking this thing over. Why should Crude Oil Accounting stay as a unit with the Raw Product Sales Department?"

Joe MacVicar had indeed been "thinking this over." The experts didn't *know* this would be more efficient. If they knew—well, that would be different.

"Because," he leaned forward earnestly, "because, through experience, we've worked out procedures that fit our needs here. The personnel of Raw Product *know* these procedures. This is something that can't happen overnight—or, I daresay, in a large unit, at all. That's just one of the reasons, of course."

The four men mentioned above carefully prepared their case for presentation to the board at the scheduled meeting. Their major points were:

1. There was no reason to believe that the accounting function should be centralized. The Raw Product Sales Department had had its own accounting unit for many years and the system had always worked satisfactorily. The accounting function in The Kennedy Oil Company had always been decentralized. For instance, the Marketing Accounting and the Manufacturing Accounting Divisions were not administratively responsible to the Accounting Department.

2. The supervisory personnel of the Raw Product Sales Department were intimately familiar with Crude Oil Accounting Procedures. They had established a system of operating that works well and had through experience developed procedures which best fit the needs of their department. Much of this "know-how" would likely be lost in any reorganization.

3. If the accounting for Crude Oil were divorced from direct control of the Raw Product Sales Department, our salesmen and customer representatives would have difficulty obtaining the statistics they need *when they need them* in their dealings with customers. This has been very frequently a crucial factor in any Sales Department. The proposed centralization would create an excess of "red tape" and would interfere with smooth operation of the Raw Product Sales Department.

4. Concerning the transfer of the machine section, it would not lead to the claimed savings. The schedules of this section and of the data processing unit

in the Accounting Department would not dovetail as claimed. In fact, the Raw Product Sales Department was already planning to eliminate some rental equipment anyway.

5. Even if the reorganization would reduce the number of employees, the necessary discharges involved might damage employee morale to the extent that the net effect might not be beneficial to the company.

6. Since the Raw Product Sales Department would be responsible for the sale of crude oil, it should also perform the accounting function. This is in keeping with the manner in which accounting is handled by the marketing and manufacturing departments.

After presenting these six points of criticism of the reorganization, the critics offered a counter proposal for reorganization. They were willing to admit some validity to the transfer of the machine section to the Data Processing Unit of the Accounting Department. They could not, however, concede the advisability of moving the crude oil accounting section. In fact, they proposed that the unit responsible for the accounting for gas sales be transferred from the Accounting Department to the Raw Product Sales Department. The argument was that timely statistics and accounting information are needed for gas sales as well as for oil sales. Exhibits 7 and 8 show the organization of the two departments as proposed by the Raw Product Sales Department.

Howard Foster, manager of Raw Product Sales, was pointing out reasons for their counter proposal.

"Look, Dodge," he turned to the head of systems and procedures who had been directing the discussion, "look at it our way. We *sell* oil and gas. When we need information, we need it. Like the time we were work-

EXHIBIT 7

Raw Product Sales Department
(Counter-proposed)

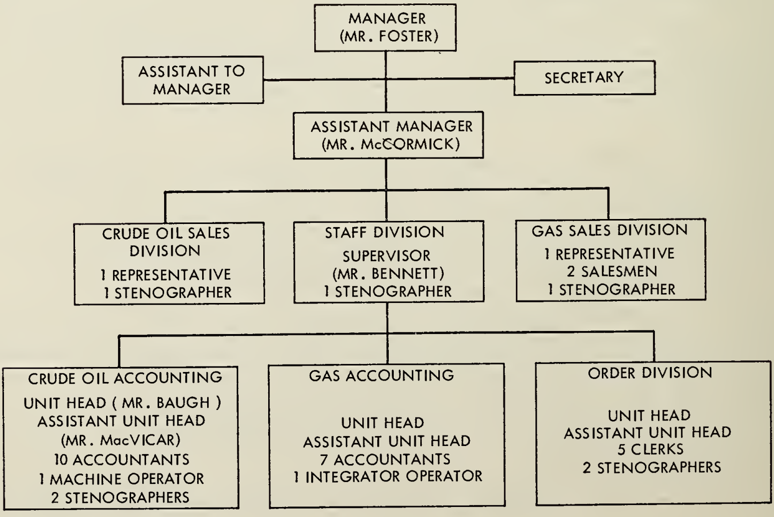
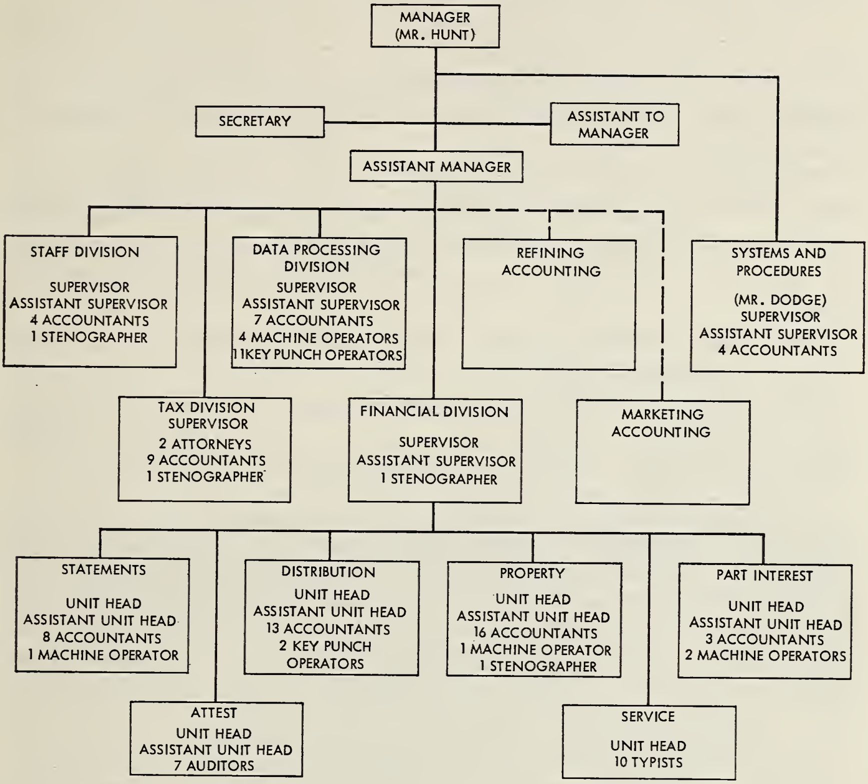


EXHIBIT 8

ACCOUNTING DEPARTMENT
(Counter-proposed)



ing on the deal to sell that large gas contract to the Amarillo Zinc Smelter Company.

"Well, they wanted to know whether our wells in the Wellston Field could provide a certain output of gas they could count on. Fair enough request. But, brother, getting those figures was a major operation.

"We called Accounting and asked to have figures, by days, on amounts taken out of the Wellston Field for the past three years. You'd have thought we'd asked for the moon with a string around it! It took 'em a week to get us those figures—a week, mind you—and in the meantime, Amarillo Zinc was about ready to call off the deal. See what I mean?" he boomed emphatically. "We need our own accounting *units,* oil *and* gas, right with us."

Bob Dodge listened attentively. For 12 years he had been streamlining the procedures of Kennedy Oil with astoundingly successful results. "We reduced the payroll by eleven people," he would report proudly, adding, "but didn't let one person go."

And so he listened now, attempting to place in perspective this sales problem as it related to the broad efficiency picture of Kennedy Oil.

"Of course you need information like this promptly," he readily agreed. "And it's Accounting's job to have it available for you."

"If we have Oil and Gas Accounting both in the Accounting Department, we'll rotate jobs so they'll all know the whole picture as well as the details. We do this in the Accounting Department already, for work interest, variety, and vacation relief. So in this way, they'll all know the big accounts.

"All you have to do, Foster, is give us your company's name and request, and we'll throw any amount of people needed into action—we'll borrow from the Property, Statements, Distribution, and other units whatever you need—and they'll click out those figures for you—pronto," he concluded.

"What about the *little* accounts, Dodge, the little deals? Who takes care of those?" boomed Foster.

Following the presentation by the representatives of the Raw Product Sales Department, the original survey team was given a chance to present further views. They made the following points:

1. Our original argument concerning the centralization of the accounting function still holds. The Accounting Department is now and always has been responsible for all accounting policy. The Marketing and Manufacturing Accounting Divisions are separate from the Accounting Department administratively only. Both look to the Accounting Department for policy. The only reason that they are separate administrative divisions is because their offices are not in Dallas. The Raw Product Sales Department Office is in Dallas, therefore, the problems of physical nonproximity are not present in this situation as they are with accounting for marketing and manufacturing.
2. It is true that the Crude Oil Accounting Unit has always been a part of the Raw Product Sales Department and this has, heretofore, been a satisfactory arrangement. But, just because something has always been, is no reason for its continuance. The Company has grown and changes are needed. Procedures and techniques accumulated by the Crude Oil Accounting Unit would not be lost in the transfer. On the contrary, this knowledge combined with that of the accountants in the Accounting Department would benefit all concerned.
3. The Accounting Department has always worked closely with other departments in providing timely statistics and accounting information. There is no reason to believe that "red tape" would be created by the transfer.
4. We believe that we can show where machine time savings can be made by transferring the machine section to the Accounting Department.
5. It would not be necessary to discharge any employee. The reorganization could be timed so that normal attrition would take care of reductions in employment.

Virginia Avenue Station[*]

In 1955, the Hill Oil Company was organized to operate as a distributor-jobber for a national petroleum products company. The resulting franchise gave exclusive rights to the Hill Oil Company to conduct business in a three county area in a Southern state which was being penetrated by the national petroleum company. Located within this area were two cities, X and Y, of approximately 70,000 population each and 11 towns of more than 5,000 inhabitants.

For administrative purposes, the area was divided into two districts with the main office of the Hill Oil Company in City X and a branch office in City Y. Storage facilities, from which the distribution of all products would be made, were to be located adjacent to the offices in both cities.

The Hill Oil Company was formed with five stockholders, three of whom were active in company operations. John Hill, president and manager of X District, had been associated with the national petroleum company for 16 years as a field representative and was well versed in the problems of distributing petroleum products. George Johnson, vice-president and manager of Y District, also had been associated with the national petroleum company as a salesman in a midwestern state. John Coffee, secretary and treasurer, had no previous experience in the petroleum distribution field but was experienced in financial and accounting matters.

In August, 1955, Hill and Coffee began looking for desirable locations for gasoline service stations in City X. They were aided in their search by advice from local land developers, civic club representatives, the Chamber of Commerce, and other local businessmen. Combining this local advice with the information contained in a market survey report compiled by the national petroleum company before the franchise had been granted, enabled the Hill Oil Company to select sites for their distribution point and eight service stations by November, 1955.

Financing the construction of a sufficient number of service stations to establish their products in the area was the first major problem encountered by the Hill Oil Company. After considering several alternatives, the officers of the Hill Oil Company decided to accept the following plan suggested by the national petroleum company:

1. The parcels of land would be acquired with company funds.
2. Short-term construction loans would be secured from local sources. Each station would cost between $40,000 and $50,000 for land, building, and permanent equipment.

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[*] Prepared by Frederic A. Brett, University of Alabama.

3. Construction loans would be paid off within six months to a year by long-term loans arranged for and guaranteed by the national petroleum company.
4. The Hill Oil Company would lease the facilities to the national petroleum company for a period of 25 years.
5. The national petroleum company, in turn, would lease the facilities back to the Hill Oil Company.

Once the Hill Oil Company had obtained options on the service station sites, a market survey team from the national petroleum company entered the picture to make an up-to-date study of each location. This service by the national petroleum company was extended to distributors whenever the national petroleum company was financially involved in the installation.

Results of this market survey indicated that the most desirable location to start operations was a 150 by 100 foot corner lot at the intersection of Virginia Avenue and State Street. The market survey data pertaining to this location is given below:

1. Virginia Avenue was a string street connecting a large residential area with a shopping center.
2. There were over 1,100 houses in the trade area. With but a few exceptions, these houses were classed in the $10,000 to $18,000 cost bracket.
3. State Street was one of the three through streets in the city.
4. State Street was traveled by workers going to and from the downtown business district and industrial area.
5. City X was an industrial city where many of the plants worked on a three-shift basis.
6. A very high percentage of the workers used private automobiles as transportation to and from work. Car pools were quite common for residents in the trade area.
7. Approximately 35 percent of the families living in the trade area operated two or more cars. Over 60 percent of the families owned power lawn mowers or outboard motors.
8. A traffic count indicated that the intersection of Virginia Avenue and State Street should support a 20,000 to 25,000 gallon service station. There were no service stations within six blocks of the intersection.
9. It was estimated that a high percentage of the station's business would be received from housewives because of the location of the station at the intersection. This opinion was based on a national survey which reflected that most women drivers (nonworkers) will stop for gasoline and service on the way to shopping centers but will very seldom stop en route home after completing their purchases. On the other hand, workers usually stop for gasoline and service on their way home from work rather than on their way to work in the morning. Only a relatively small part of the station's business was expected from this latter group as patrons would have to cross over State Street to use the station's facilities.

Estimated opening date for the new service station was March 1, 1956, and interviews were held to find a dealer to operate the station. By December, 1955, the field of prospective owner-operators was narrowed to two men. One was Albert Maze, a college graduate, 28 and single, who at the time was employed as a salesman for a local automobile dealer. Maze was dissatisfied with his earnings and wanted to get into business for himself. He had approximately $3,000 to invest in the business and appeared to be industrious and of good moral character. The other prospective dealer was Arthur Able, a high school graduate, 43, married, with an adopted teen-age son who attended high school. Able was very active in civic clubs and attended the Presbyterian Church in the area. Mrs. Able also was very active in community affairs and taught an adult Sunday school class. For the past seven years, she had been employed in the local offices of the Veterans Administration.

Able had been unemployed since October, 1955, when he sold his grocery store to a national chain. During the five years he had operated the grocery store, he had managed to save approximately $7,000 which he was willing to invest in the service station.

After careful consideration, Hill and Coffee decided to lease the station to Able. Stated reasons for this choice were: (1) Age and marital status. (2) Activities in civic organizations and church. (3) Available cash for investment. (It was estimated that between $5,000 and $7,000 was needed to start a gasoline service station.) (4) Education. (It was thought that a college graduate might resent having to wash windshields and sweep out cars and that a high school graduate would have sufficient education to be able to understand and maintain proper station records.) (5) Able had proven his ability to be successful in business as an entrepreneur.

While the station was being constructed and readied for operation, Hill arranged for Able to attend a training school conducted by the national petroleum company. Able made a very favorable record during the 30 days he attended the school.

Construction of the Virginia Avenue station was delayed beyond the estimated March 1 opening date, and Able busied himself with a house-to-house canvas soliciting applications for courtesy cards. By March 15, when the station was set to open, Able had received more than 500 applications for courtesy cards which he forwarded for approval and issue.

During the first two months of operations, Coffee made daily visits to the new station to aid Able in setting up proper records for financial and inventory control. In addition, Coffee worked long hours in advising Able on the recommended practices for displaying merchandise and following up on service work performed at the station. It should be noted at this time that Coffee and the Hill Oil Company could act only in an advisory capacity as Able was the proprietor of the business and had the final say on operating practices. The Hill Oil Company, however, did have some authority over the operations of the station in that Able's lease could be terminated by the Hill Oil Company on 30 days notice.

Coffee's reports to the Hill Oil Company during the first few months of operation reflected that Able was not too receptive to suggestions on proper inventory control, merchandise display, and maintenance of financial records. This lack of conformity to prescribed practices came as a surprise to Hill who had been impressed with Able's cooperative attitude demonstrated at the national petroleum company's training school.

From the beginning, the station appeared to be successful and by December, 1956, gasoline sales had passed the 17,000 gallons per month mark. Sales of oil and grease, TBA items (tires, batteries, and accessories), and service, however, had not come up to the standards[1] set by the distributor. Detailed sales data are shown in Exhibit 1.

Coffee continued to visit the station at least twice a week, and through persistent efforts, convinced Able that the operating procedures recommended by the national petroleum company and the Hill Oil Company were scientifically designed to aid the dealer in developing a more profitable business. In July, 1957, the station passed the 20,000 gallon per month mark for the first time.

Up to this time, the Virginia Avenue station had been a very profitable operation for the Hill Oil Company. However, Able had begun to complain that his profits had not increased with the increase in business volume. Coffee, aided by the district salesman from the national petroleum company, began an investigation to determine why the dealer's profits should fall off when the profits to the Hill Oil Company were increasing. Results of this investigation revealed the following: (1) Accounts receivable had steadily climbed to almost $4,000 during the first six months of business in spite of the large number of credit cards in the area. (2) Sales of TBA items had increased to an average of over $1,000 a month but an inventory count and the sales records of the Hill Oil Company to the Virginia Avenue station showed that a much greater profit should have been realized from this source. This adverse profit picture was attributed to the fact that Able had failed to heed Coffee's advice to keep the storeroom under lock and key and that as a result Able's gross profit on tires and batteries was running only 11 percent instead of the estimated 25 percent and on accessories only 6 percent instead of the estimated 38 percent. (3) Able, in conjunction with other merchants in the area, had begun to issue trading stamps without any increase in the prices of items sold. (4) Able had introduced some sales promotional ideas of his own but had failed to carry through on any of them. These projects had increased his operating costs without any corresponding increase in gross revenue.

Coffee worked with Able to correct these deficiencies but during the next six months, no appreciable changes took place. At no time was Able

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[1] Sales standards set by most distributors of petroleum products in the area were: 1 gallon of oil for every 70 gallons of gasoline sold; $50 in TBA items for every 1,000 gallons of gasoline sold; and $27 in service income for every 1,000 gallons of gasoline sold.

EXHIBIT 1

Arthur Able, Proprietor

Date	*Gasoline (Gallons)*	*Oil and Grease (Gallons)*	*TBA (Dollars)*	*Service (Dollars)*
1956				
July	11,120	182	344	438
August	11,538	183	1,534	360
September	15,672	200	756	390
October	16,377	173	904	420
November	17,073	171	1,666	366
December	17,974	188	818	417
6 months' average	14,959	183	987	398
1957				
January	15,877	187	1,214	388
February	15,465	142	925	451
March	18,269	186	1,837	501
April	16,234	165	1,188	456
May	18,297	196	969	423
June	19,749	237	1,419	392
July	21,041	219	872	490
August	20,831	215	1,185	609
September	19,014	167	1,098	456
October	18,186	173	1,343	574
November	18,537	165	1,125	476
December	17,172	162	1,096	438
12 months' average	18,223	184	1,189	471
1958				
January	16,110	153	878	440
February	13,312	125	856	375
March	14,254	160	1,002	381
April	15,622	197	765	441
May	16,370	236	805	470
June	14,278	197	538	392
July	14,220	169	977	465
August	12,990	177	536	440
September	13,600	142	708	402
October	15,024	146	1,336	477
November	16,028	156	1,094	402
December	15,985	140	739	370
12 months' average	14,816	166	854	421
1959				
January	16,730	164	595	422
February	15,695	154	502	368
2 months' average	16,213	159	549	395
32 months' average	16,208	176	985	434

aggressive enough to reduce his receivables below $3,500. During this period, extracts from Coffee's reports to the Hill Oil Company reflected the following conditions at the Virginia Avenue station: (1) When the station had first opened, Able had worked from eight to 10 hours a day. Beginning in September, 1957, Able began spending less and less time at the station and by January, 1958, he was present at the station less than an average of five hours a day. The station continued to be open 14 hours a day. (2) The station had gradually taken on a dirty appearance and the attendants seldom wore clean uniforms. This condition had been pointed out by Coffee on several occasions but Able had done nothing about it. This description did not apply to Able who was always neat in appearance. (3) Turnover of attendants was high and none of the four attendants who had started with the business were still employed. (4) Replacement attendants did not appear to have the characteristics necessary for the type of trade catered to. At one time, several pictures of nude women were prominently displayed on the office walls. (5) Statements and hints by attendants and customers suggested that Able's personal habits included excessive drinking, gambling, and some running around.

In January, 1958, Able decided to stop giving trading stamps. Almost immediately, sales volume fell off and Able found himself in financial difficulties. Bad checks issued to the Hill Oil Company forced Hill to require cash on delivery for all items purchased from the Hill Oil Company.

Business continued to fall off and in March, 1958, Able, blaming the low volume on his failure to give trading stamps, reinstated their issuance and raised the price of gasoline one cent a gallon to offset his increased costs. Business did not improve to any marked degree and when the seasonal upturn did not occur in June, Able decided to take a full-time job as a salesman for a tobacco company and turn the operation of the station over to a manager. To finance his absentee ownership, Able was forced to secure working funds from an outside source. The local bank was unwilling to make the loan to Able unless he could get the Hill Oil Company to endorse the note. Hill, at first, was reluctant to accommodate Able, but when Able was unable to secure funds from any other source and to protect the several thousands of dollars Able owed the Hill Oil Company, Hill finally agreed to sign the note.

July, August, and September were very poor months for the station and in October, Able gave up his job as a salesman and again took over active management of the station.

By January, 1959, the Virginia Avenue station ceased to be a profitable operation for both the Hill Oil Company and Arthur Able. Able had, on several occasions, expressed a desire to sell the business and on March 1, 1959, with the consent of the Hill Oil Company, sold his interests to Bob Baker for $4,500 excluding the receivables which had mounted to over $4,800. Able estimated that after paying off his bank loan, he would recover approximately half of his original investment if he could collect 80 percent of his outstanding receivables.

Bob Baker, 35, married, with one daughter, had spent the previous 10 years as an outside salesman for a wholesale hardware company. He had been relatively successful in his work and at the time he resigned his position, he had over 350 accounts to service and was earning better than $750 a month in commissions. He had decided to change jobs because he was tired of traveling and because he believed he could make more money in business for himself. The latter reason was unhesitatingly given top rating by Baker who stated he needed large amounts of cash income to meet his personal obligations.

A personnel check by the Hill Oil Company revealed the following conditions: (1) In 1954, Baker had taken out a very large 10-year insurance program which required premium payments of over $100 a month. (2) Baker's living expenses, including mortgage payments on his expensive home and car, averaged more than $700 a month. (3) Friends and neighbors attributed his living beyond his means, with the resulting need for cash inflow, to his desire to give his wife and daughter everything they wanted. Baker had left college after two years to marry the daughter of a wealthy local industrial executive. In attempting to maintain her standard of living, Baker had gone heavily in debt with installment purchases.

Baker had no available cash when he agreed to purchase the Virginia Avenue station from Able. To consummate the deal, he borrowed $2,500 from a local bank and $2,000 from his mother-in-law. Hill and Coffee were rather skeptical about Baker's ability to manage a service station and suggested that he attend the national petroleum company's training school before taking over the business. Able had agreed to stay on and manage the station for the four-week period Baker would be at school. Baker would not agree to this arrangement, preferring to receive on-the-job training from Coffee while he was running the station.

Baker was an apt pupil and quickly put into effect recommendations made by Coffee. His first steps were to clean up the station, hire three new attendants (one of the attendants hired by Able was kept on because of his ability to perform minor motor repairs), and institute controls over all items in inventory. Coffee worked with Baker during April and May on a daily basis setting up proper records and suggesting merchandise displays to increase the sale of TBA items. In this latter area, Coffee noted that the salesman for the national petroleum company was not visiting the dealers (at this time the Hill Oil Company had 17 service stations in operation) as he was supposed to and that marketing suggestions had to be relayed through Coffee to the dealers. Hill notified the national petroleum company of this condition and in June, 1959, a new sales representative was appointed to service the area.

Within a relatively short period of time, the Virginia Avenue station began to prosper and once again became a profitable operation for the Hill Oil Company. Baker also realized profits from the business as reflected in his profit and loss statement for the month of May, 1959, shown in condensed form below:

VIRGINIA AVENUE STATION
Profit and Loss Statement
Month of May, 1959

Sales		$8,115.06
Cost of sales		
Inventory 4/30/59	$4,536.71	
Purchases	5,257.37	
Total available for sale	$9,794.08	
Less inventory 5/31/59	3,740.80	
Cost of sales		6,053.28
Gross profit		$2,061.78
Operating expenses		
Salaries	$ 741.81	
Rent (on a per gallon basis)	141.43	
Advertising	161.19	
Taxes and license	30.85	
Laundry and uniforms	65.54	
Station supplies and utilities	213.62	
Cash over or short (short)	22.21	
Depreciation	77.73	
Insurance	7.08	
Interest	15.00	
Total expenses		1,476.40
Net profit		$ 585.38
Gross profit percentages:		
Motor fuel	17.6%	
Motor oil	40.0%	
Accessories	43.0%	
Tires, tubes, and batteries	14.7%	
Total gross profit	25.4%	

During the remainder of 1959, Baker continued to show a profit of between $500 and $600 a month in spite of the fact that the sale of gasoline never did reach the 17,000 gallon mark established in May. See Exhibit 2 for detailed sales data. Coffee, who continued to visit the station twice a week (this was a standard procedure for all of the service stations controlled by the Hill Oil Company) noted in his reports to Hill that Baker kept one of the cleanest stations in the area and had excellent inventory records for all items carried in stock. However, on several occasions, Coffee noted that Baker's attitude appeared to be wrong for a service station operator in that he gave the impression that he resented having to personally serve customers and was reported as being very rude to customers when attempting to collect past due accounts.

In February, 1960, Baker's profits fell below the $500 mark for the first time and Baker informed Hill that he would like to sell the business and get back on the road selling where he could make enough money to support his family. Hill and Coffee both tried to convince Baker that his operation would be more profitable in the future if he would improve his customer relations and reduce his outstanding receivables which were out of line with the volume of business he was doing. Hill was anxious to keep Baker at the Virginia Avenue station not only because it was a very profitable operation for the Hill Oil Company but because it cost between $3,000 and $3,500 in training costs, loss of sales, and rental income to change dealers at a station.

Baker went along with the recommendations made by Hill and Coffee and made a concerted effort to reduce his receivables. In addition, Baker lengthened the working day to 15 hours and was on hand, except for mealtimes, to supervise the station's operations from the time it opened until it closed at nine each evening.

During the next two months, gasoline sales volume increased more than 2,500 gallons which was over 1,000 gallons more than the expected seasonal fluctuation. Coffee attributed this success to the fact that Baker was very cooperative in Hill's city-wide jobber-dealer promotional activities as well as having some very good merchandising ideas and plans of his own. However, Baker, like Able, was very weak in carrying through with his promotional plans once they had been started.

EXHIBIT 2

Bob Baker, Proprietor

Date	*Gasoline (Gallons)*	*Oil and Grease (Gallons)*	*TBA (Dollars)*	*Service (Dollars)*
1959				
April	16,109	178	$ 926	$ 501
May	17,182	192	881	565
June	15,030	167	858	489
July	15,300	189	1,105	535
August	14,791	158	914	470
September	15,760	159	716	552
October	16,468	152	815	463
November	15,669	114	1,064	444
December	15,528	120	522	414
9 months' average	15,946	159	832	472
1960				
January	14,013	136	810	552
February	13,119	114	545	453
March	14,836	124	575	459
April	15,628	157	602	491
4 months' average	14,399	133	634	489
13 months' average	15,504	152	775	488

On April 21, 1960, Baker informed Hill that he was selling the station and that he was going back to his old job as a salesman for the wholesale hardware company. Neither Hill nor Coffee expected Baker's move at this time and were placed in the awkward position of finding a new dealer on short notice. Their task was made more difficult by the fact that they had increased their service station operations to include 27 stations and had exhausted their supply of available qualified dealers.

Charles Case, the one attendant Baker had kept on when he acquired the station from Able, expressed an interest in buying the station if financial arrangements could be made. He had no money of his own and would need help in securing a loan from a local bank.

Baker agreed to sell the business to Case for $2,000 but excluded his receivables and equipment. The equipment would be leased to Case for $50 a month until its cost price of $3,200 was paid. Case at first objected to the $3,200 figure for the equipment as this was the amount Baker had paid Able for it the previous year. Baker easily convinced him, however, that the $3,200 figure was fair in that no interest was being charged for the leased equipment.

Case attempted to get a loan from several sources but was unsuccessful until he contacted a Mr. Z who agreed to loan him $2,000 if he could get two co-signers to the note and have it endorsed by the Hill Oil Company. Case convinced his father and a friend to act as co-signers. He then contacted the Hill Oil Company and requested that they endorse his note. Hill and Coffee were not enthusiastic about the proposition but after reviewing the situation decided that their only alternatives were to run the station themselves until a dealer could be found or to endorse Case's note. They chose the latter alternative.

Charles Case, 25 and single, had quit college (Engineering) after one year. Since leaving college, he had worked at several selling jobs before going to work for Arthur Able in September, 1958. He had been kept on by Baker in spite of his untidy appearance because of his mechanical ability. Under the watchful guidance of Baker, his appearance had improved and he had become familiar with the many problems associated with the operation of a service station.

Case began operating the station on May 1, 1960, and almost immediately, sales volume fell off. Coffee tried to work with Case in setting up his records and inventory control techniques, but Case ignored most of his recommendations. Coffee reported to the Hill Oil Company that Case had reverted to his old habits of coming to work unshaven and in a generally untidy uniform and that the appearance of the station had deteriorated to a point where some corrective action was necessary if the station was to remain in operation.

Subsequent reports by Coffee, who was spending three or four days a week at the station, revealed that false records were being maintained for the gasoline and TBA accounts and that Case was allowing excessive credit to customers who had proven their unwillingness to pay accounts to previous owners. Case continued to ignore most of the recommendations made by Coffee on how to improve the sales volume and began to spend less and less time at the station.

Attendants hired by Case soon took advantage of his absences, and tires, batteries, and small tools began to disappear from the storeroom and the shop.

Case was married early in June and took the rest of the month off for a honeymoon. During his absence, the attendants were left to run the station as best they could. Sales data for June (see Exhibit 3) reflected the poorest June figures since the station had been started.

Case had been on a cash basis with the Hill Oil Company since he took over the station. However, while he was away on his honeymoon, the Hill Oil Company was forced to extend limited credit to keep the station operating. Upon his return to work in July, Case was unable to pay his debts and decided to sell the business.

As soon as it was known that Case was looking for a buyer, Donald Dart, the number two man at a competitor's station, offered to buy the business if the price was right.

Donald Dart, 28, married, with no children, had been employed as an attendant at another national brand petroleum company's station for six years. This was the only job he had held since being graduated from high school except for serving a four-year hitch in the United States Army. Dart was not particularly interested in civic clubs but was active in his church (his father was a Baptist preacher) and in the National Guard where he held the grade of Sergeant. Mrs. Dart had been employed as an operator in a beauty salon for three years but was expecting and would have to quit her job in a few months.

EXHIBIT 3

CHARLES CASE, PROPRIETOR

Date	*Gasoline (Gallons)*	*Oil and Grease (Gallons)*	*TBA (Dollars)*	*Service (Dollars)*
1960				
May	14,359	170	$388	$369
June	13,141	170	558	416
July*	7,339	88	488	192
2 months' average	13,750	170	473	393

* July figures maintained only through eighteenth of month.

Dart had several consultations with Hill and Coffee and finally agreed to make a $6,000 loan at the local bank to buy Case's interest in the station and to allow himself sufficient working capital to get the station back on a paying basis.

Negotiations with Baker resulted in a cash purchase of the equipment at a $700 discount and $2,500 was paid to Case for his interest in the business. Case retained his receivables which had mounted to over $800 during the two and one-half months he operated the station. The $2,500 was never actually paid to Case but was used to pay off his debt to the Hill Oil Company and half of his loan from Mr. Z.

The transition period from the time Case decided to sell the business until the time Dart began operating the station was about six weeks. This delay in change of ownership was due to Dart's careful investigation of the situation and the fact that Virginia Avenue was being widened and repaved by the city. Construction work was completed on August 23, 1960, and Dart opened for business on August 25.

Dart had learned the service station business during his six years with a competitor's very successful station and decided not to attend the national petroleum company's training school. He immediately began to institute controls and operating techniques to put his station on the same basis as the station he had just left. His first steps were to clean up the station and require the attendants to wear clean uniforms. He stressed courteous service and began a pick-up and delivery service for wash and grease jobs. He very quickly adopted the record system recommended by the Hill Oil Company and put all TBA items not on display under lock and key.

Slowly the sales volume of the station began to pick up in spite of competition from a new service station which a competing national brand petroleum company had opened on September 1. This new service station was located on Virginia Avenue, two blocks west of the intersection of Virginia Avenue and State Street.

Dart stressed the sale of TBA items and service and by December, 1960, was showing a profit for himself as well as for the Hill Oil Company. Detailed sales data are shown in Exhibit 4.

During the next few months, Coffee's reports to the Hill Oil Company reflected that Dart was spending approximately 10 to 12 hours a day at the station; he required his personal approval on all credit extended to customers; he had not allowed his receivables to exceed $300 at any one time; and, he was cooperating with the other dealers for the

EXHIBIT 4

DONALD DART, PROPRIETOR

Date	*Gasoline (Gallons)*	*Oil and Grease (Gallons)*	*TBA (Dollars)*	*Service (Dollars)*
1960				
September	11,115	135	$ 514	$311
October	14,035	136	703	363
November	13,573	151	1,091	392
December	16,111	134	932	408
4 months' average	13,709	139	810	369
1961				
January	15,974	148	1,026	485
February	14,132	143	708	464
March	16,080	184	905	515
April	15,659	149	810	544
May	16,013	190	1,030	463
5 months' average	15,572	179	896	494
9 months' average	14,744	152	858	438

Hill Oil Company in putting on special sales of TBA items which were advertised in the local papers on a joint effort basis.

In June, 1961, a local independent petroleum company began construction of a service station across the street from Dart's location. Other stations operated by the independent petroleum company in the city were underselling competing national brand petroleum products with gasoline prices running from two to three cents a gallon less on all grades of gasoline.

*Belwood Industries, Inc.**

Manufacturer of Custom-Designed Kitchens

Belwood Industries, Inc., located in Ackerman, Mississippi, began operations immediately after World War II. For the first few years its output primarily was in standard mill work items, but it gradually shifted over to high-quality, custom-designed kitchens, appliance installation units, and wall furniture ensembles. Since 1955 it has specialized in the Belwood Deluxe Kitchen which has accounted for about two-thirds of its output.

Early in 1960, Mr. J. S. Moore, Jr., President of Belwood, began a review of his manufacturing program to determine whether the firm should continue to emphasize custom built items, particularly kitchens, or should plan on producing standardized items. If standard items were manufactured, it was felt that volume production could be achieved with considerable reduction in unit cost and price.

Early History. Mr. Moore, an engineering graduate of Mississippi State University, started his career in the early 1930's as an employee of the United States Army Corp of Engineers. In 1938 he became manager of a 90,000 acre land utilization project located near Ackerman, operated by the United States Department of Agriculture. He resigned his position with the Federal Government in 1947, and established Belwood Products Company. A building was leased from the Ackerman Planing Mill, and machinery designed for manufacturing wood moldings and general mill work items was purchased.

Within a few years, Mr. Moore realized that the future of the mill work business was uncertain. Wood moldings were being used less and less in new home construction. There was also a trend by home builders to use more prefabricated items, such as windows and doors, thereby further reducing the market for general mill work products. Transportation costs, furthermore, meant that any expansion in the market area beyond 100 miles was extremely difficult.

The desirability of manufacturing a product, or products, which could be sold in the growing markets of Birmingham, Memphis, New Orleans, and other large cities was becoming increasingly obvious. Post World War II trends clearly indicated that the principal economic development was taking place in metropolitan areas. "My first objective," Mr. Moore said, "was to determine in what direction I could go and have a better potential than general mill work. My specific decision to manufacture kitchen cabinets actually was somewhat accidental. At that time, I was building my own home, and my wife and I wanted kitchen cabinets with sliding doors. I built these in the planing mill. Before my house was completed, several neighbors came by and wanted similar cabinets. I began taking orders."

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* Prepared by William T. Hicks, University of Mississippi.

The machinery owned by Belwood was readily adaptable to precision dimension parts needed in custom cabinet manufacture. At first cabinets were sold in unfinished form, but it was soon realized that customers wanted completely finished cabinets. As the possibility of manufacturing kitchen cabinets became apparent, a decision was reached that the best opportunity was in producing custom-designed, high-quality items. Although it was recognized that the market probably would be limited to relatively high-priced homes, the conclusion was that a satisfactory potential existed if both remodeling and new home construction were considered. Moreover, it appeared that this would be a market in which large manufacturing firms would not be particularly interested. Custom-designed units could be produced only on individual order specification, and direct competition with low-cost volume producers thus would be avoided.

Products. As production of cabinets expanded, plans were developed for a complete kitchen. Units to house all types of appliances and special purpose cabinet installations, including a "Lazy Susan" for corners and "Park-O-Peg" molding for end walls, were designed. Emphasis was gradually shifted from cabinets to the Belwood Deluxe Kitchen. By 1953, this complete kitchen was the basic product of the company.

For the Belwood Deluxe Kitchen, all units were custom-manufactured to individual specifications. Cabinets and appliance installation units could be varied in height, width, and depth. The heights of working surfaces were designed for the comfort and work habits of the individual housewife. Special purpose cabinets were designed and located in accordance with the family needs. Cabinet widths and depths were similarly adaptable to the size of the kitchen.

A wide selection in the choice of woods also was provided, including mahogany, walnut, oak, birch, knotty pine, and maple. Finishes were in the natural wood, with interiors in selected color. Each family thus could select a wood which would be compatible with the furniture or paneling in other rooms, and which would reflect the individual housewife's preference. It appeared to Belwood that the growing popularity of the "open kitchen" and combination kitchen-family room should greatly increase the demand for fine custom-designed kitchens.

The business recession of late 1957 highlighted a need for a lower priced kitchen in order to maintain sales volume. Consequently, a standard type of kitchen was placed on the market. It was manufactured in standard dimension units[1] only, with choice of woods limited to white pine or knotty pine either in a natural finish or in various stains. In 1958 the use of Pine was discontinued and maple, either in a natural finish or a deeper toned fruitwood stain, was used. The price was 15 to 20 per cent less per comparable unit than the Deluxe line. As explained by Mr. Moore, "this lower over-all delivered price for a high-quality product is possible only through a standardization that allows no deviation from the dimensions available. Both cabinets and appliance housing units included the same quality construction features as the Deluxe Kitchen."

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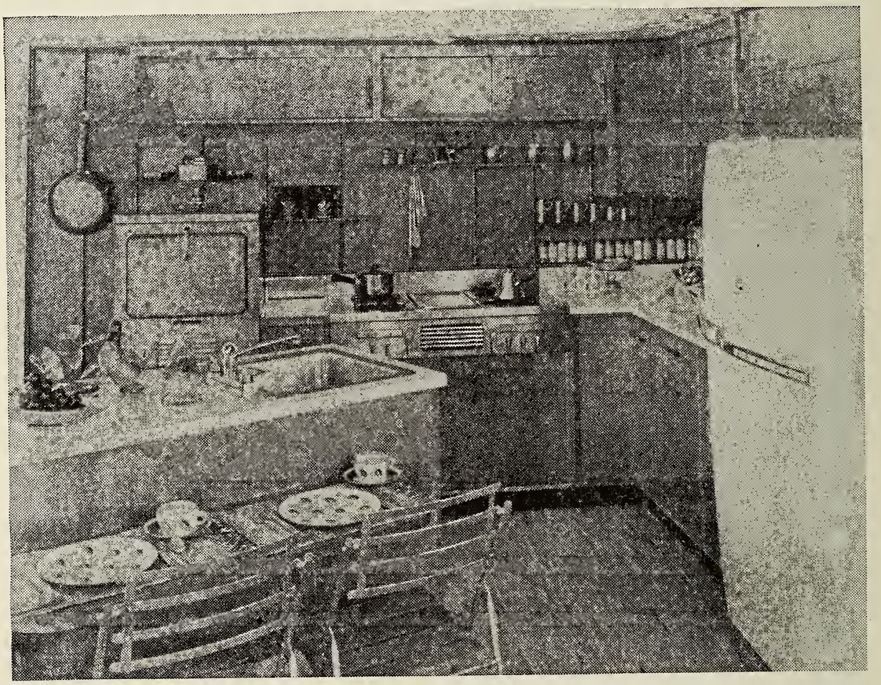
[1] Base cabinets were 30 inches high and 24½ inches in depth, with a standard width for each type of unit.

EXHIBIT 1

A Belwood Kitchen



Plans were developed from time to time for other items. Custom units for family rooms and dens, with unique features such as storage walls with access from either side, were occasionally designed. Built-in arrangements for TV and Hi-Fi, bars, and specialized cabinets were popular on a small scale.

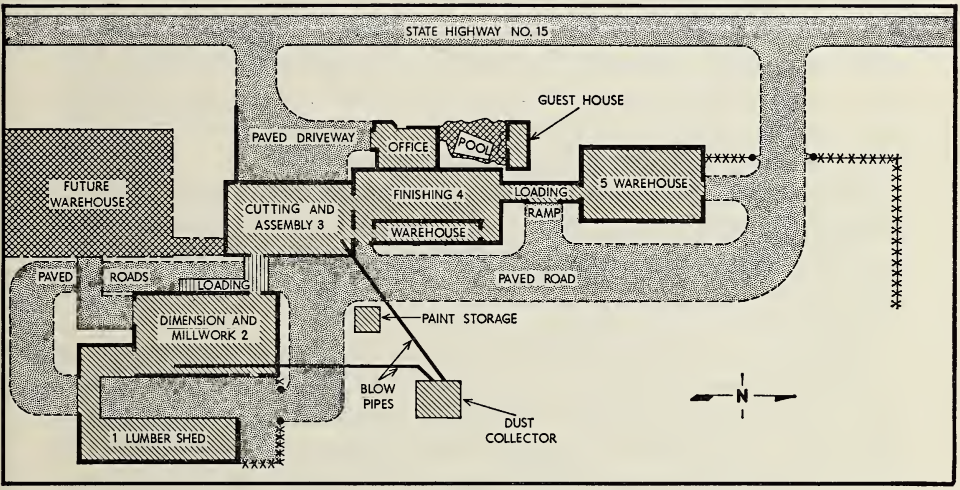
Functional ensembles for the bedroom, dressing room, and bath were designed and manufactured for several customers. Custom-built vanities for both bedroom and bath enjoyed modest sales. But total sales for items other than kitchen units remained small.

Plant Operations. During the first few years of manufacturing kitchen cabinets, operations were carried on in the building rented from the Ackerman Planing Mill with machinery designed for general mill work. Construction of a new plant, especially planned for the complete custom Deluxe Kitchen, was begun in 1953. This was located on the outskirts of Ackerman, in park-like surroundings, about one mile from sidings of both the Illinois Central and the Gulf Mobile and Ohio railroads.

Additions and improvements were made to the plant from year to year. By 1960 the factory consisted of 36,000 square feet of floor space on one level, a turn-table with three types of completely equipped Belwood Kitchens on display, offices, and sales and drafting rooms. Adjoining the factory, a guest house and swimming pool were constructed. The guest house featured Belwood built-in ensembles, and the swimming pool served a dual purpose in that it increased the beauty of the layout and acted as a reserve water supply required by the insurance underwriters.

EXHIBIT 2

Plant Layout



The layout of the factory has been planned for efficient movement of materials. From the receiving area, which includes storage space for wood and other raw materials, raised roller-conveyors lead to individual machines. Such conveyors provide efficient movement throughout the plant, from the original storage area to the final shipping platform.

Much of the machinery has been designed and constructed by Belwood in order to meet its particular precision needs. An adjustable double-end tenoning machine, for example, provides the basic dimension control operations. A special purpose drilling machine, with multiple adjustable drills, was made to provide precision work on custom-designed items. Equipment also includes an electrically driven moulder which shapes wood to desired specifications on four sides with one operation.

Sanding equipment, which is basic in providing a rich natural wood finish, was selected especially for the Deluxe Kitchens. Forced-air exhaust ducts lead from all machines to a large dust-control unit located some distance from the factory.

Manufacturing operations are designed to provide a tolerance not to exceed $\frac{1}{64}$ of an inch. Such precision is of major importance in constructing smoothly operating drawers, doors, and special purpose units. Quality and design can thus be controlled, Mr. Moore emphasizes, to even more exact tolerances than that achieved by the master craftsman—and at a much lower cost. Drying operations are likewise regulated by use of multiple ultraviolet lamps.

Purchasing. Belwood's largest expense item is for wood. For a Deluxe Kitchen, the original cost of the wood is equal to about half of the final selling price. Efficient purchasing is therefore necessary at all times in order to control costs.

It has been the experience of Belwood that reasonable prices can be obtained only when purchases of wood are in carload lots. This is especially true of the premium grades of wood which Belwood uses in its Deluxe Line. Complicating the purchasing problem is the fact that much of the high grade veneer is obtainable only on special order.

Car-lot buying, moreover, creates an inventory and storage problem. Adequate supplies of each kind of the wide selection of woods offered must be maintained. On imported woods, such as mahogany from Honduras, birch from Finland, and maple and walnut from Canada, delivery can be slow.

Shipping. A major problem in marketing the Belwood kitchen is that of delivery from the factory to the home. The luxurious finish of each item must be protected from scratching. Shipments by railroad can be made only when items are strapped with metal bands in individual cardboard cartons. On custom-built cabinets and fixtures, each carton must be adjusted to the particular size. For the typical Deluxe Kitchen, the packaging cost averages around $50.00.

Shipping costs on kitchens, moreover, are particularly high because of the balloon weight involved. Freight rates on LCL shipments are three times as high on finished cabinets as on the equivalent unassembled weight. Cost of shipping a kitchen weighing 1,000 pounds is about $50 for 500 miles and $75 for 1,000 miles.

Truck shipments direct from the factory to the home, with items wrapped individually in blankets, are most satisfactory, but the cost runs 45 cents per mile. Since the delivery date on each kitchen must be closely correlated with the progress in constructing the new home or in remodeling the old one, only one kitchen usually can be shipped at a time. Consequently, truck shipments beyond 250 miles are relatively costly.

Finances. Prior to July 1, 1959, the firm was operated by Mr. Moore as an individual proprietorship. On that date it was incorporated and the name changed from Belwood Manufacturing Company to Belwood In-

EXHIBIT 3

BELWOOD INDUSTRIES, INC.*
Consolidated Profit and Loss Statement, 1945–59

	1954	*1955*	*1956*	*1957*	*1958*	*1959*
Receipts	$232,903	$361,710	$329,190	$240,818	$507,167	$334,357
Cost of sales						
Inventory 1/1	$ 12,609	9,467	$ 11,740	$ 11,413	$ 45,740	
Purchases	$ 93,148	$181,282	$195,715	$146,711	$217,400	
Plus: Freight increase	$ 4,722	$ 5,688	$ 5,474	$ 2,872	$ 9,667	
Merchandise available for sale	$110,479	$196,437	$212,929	$160,996	$272,807	
Less: Inventory 12/31	$ 9,466	$ 11,739	$ 11,413	$ 45,740	$ 32,713	
	$101,013	$184,698	$201,516	$115,256	$240,094	
Labor	$ 40,165	$ 71,006	$ 55,522	$ 42,700	$ 96,747	
Maintenance and Supplies	$ 16,151	$ 21,512	$ 2,146	$ 16,938	$ 6,915	
Total Cost of Sales	$157,329	$277,216	$259,184	$174,894	$343,756	
Gross profit	$ 75,574	$ 84,494	$ 70,006	$ 65,924	$163,411	
Operating expenses						
Salaries	$ 14,620	$ 2,610	$ 3,023	$ 2,371	$ 5,403	
Interest		$ 536	$ 492	$ 630	$ 744	
Rent		$ 3,357	$ 2,200	$ 1,939	$ 2,115	
Taxes	$ 8,316	$ 6,165	$ 4,141	$ 3,693	$ 5,142	
Depreciation	$ 7,549	$ 9,017	$ 7,528	$ 7,022	$ 15,056	
Repairs		$ 917	$ 1,947	$ 76	$ 16,611	
Bad debts				2,215	$ 2,996	
Utilities	$ 6,523	$ 4,002	$ 3,741	$ 3,378	$ 5,720	
Insurance	$ 6,055	$ 6,600	$ 5,134	$ 7,053	$ 5,416	
Travel	$ 2,140	$ 2,931	$ 2,005	$ 1,967	$ 1,107	
Donations, dues, and miscellaneous	$ 5,994	$ 2,145	$ 592	$ 431	$ 6,125	
Advertising	$ 28	$ 763	$ 265	$ 623	$ 7,232	
Office Expenses and professional	$ 1,160	$ 2,394	$ 2,874	$ 1,206	$ 8,654	
Telephone		$ 2,394	$ 1,568	$ 1,345	$ 1,603	
Gas and oil	$	$ 2,452	$ 1,911	$ 2,029	$ 2,054	
Bid bonds		$ 1,713				
Moving expense					$ 1,356	
Discounts allowed					$ 3,230	
Total Operating Expense	$ 52,385	$ 47,996	$ 37,421	$ 36,978	$ 95,034	
Net profit	$ 23,189	$ 36,498	$ 32,585	$ 28,942	$ 68,377	

* Adjusted by constant factor.

dustries, Inc. The stock is family owned, and no public offering has been made. The Board of Directors consists of members of the family.

Throughout the company's history, a large part of the earnings has been used to expand the plant and provide specialized machinery. Should a decision be made to expand the sales program, additional operating capital must be obtained from outside sources.

Sales. Mr. Moore remarked that a problem of the company throughout its operation probably had been the need for a sales program and sales organization. His primary interest, he indicated, tended to be in production and design, rather than in selling.

From the small beginning, growth was gradual and sales passed the $200,000 mark in 1954. A further increase occurred in 1955, but sales declined during 1956 and 1957. Although a number of bids had been made to institutional buyers and tract builders, a large contract was signed for the first time in 1958. Two large contracts were negotiated that year, one for 200 apartment kitchens at the University of Mississippi and the other with the U.S. Air Force Base at Columbus, Mississippi. Sales in 1958 exceeded $500,000. No large contract was made in 1959, and sales declined to $300,000.

During the first six or eight years of operation, sales generally resulted from recommendations of satisfied customers. Prospective buyers normally took the initiative in approaching Belwood, frequently visiting the factory as a first step. Each customer usually discussed his ideas with Mr. Moore and a plan was developed. Designs were then drawn for each kitchen.

One of the first specific steps to develop a sales program was taken in 1955 when a sales representative was appointed in Cincinnati, Ohio. The representative made a strong effort to develop the market, but after two years discontinued handling the Belwood line. The conclusion was that the established clientele of the representative were accustomed to handling a lower quality line of kitchens; in fact, dealers in the area generally seemed to prefer to carry standard items produced by an old line manufacturer, and hesitated to add a high-quality custom-designed line.

Belwood's early experience indicated a need for a permanent display in each town in order to illustrate the advantage of custom-built kitchens over standard equipment. Another step in the program to expand sales was the establishment in 1956 of a company-owned sales office with an effective display in Jackson, Mississippi, and Houston, Texas. Establishment of a new office cost about $25,000; $10,000 to $12,000 was necessary to set up the display, and the balance for operating capital. In 1958, Mr. Moore decided to transfer operations in Houston to an independent dealer, but continued to operate the sales office in Jackson until the middle of 1960. The office was closed because it was decided that approximately the same sales volume could be achieved through direct sales from the factory in Ackerman—a distance of 110 miles.

As a result of the early experience with the offices in Jackson and Houston, a young man was employed as a sales manager in 1958 for the purpose of establishing dealerships in a number of southern cities within a radius of 400 miles of Ackerman. The idea was that one dealer would be appointed in each town.

The procedure was for the sales manager to select the best dealer in a city who indicated an interest in the line, arrange for him to visit the Belwood plant, and then try to develop an agreement whereby the dealer would establish one or two model kitchens displaying Belwood products. A number of potential dealers came to the factory, spent two or three days, and seemed to be genuinely enthusiastic. Only six agreements, however, were signed, and only four dealers established satisfactory displays —in Birmingham, Little Rock, New Orleans and Memphis.

The four dealers have not developed a particularly significant volume of sales. Each dealer averages about one sale per month of the Deluxe line, and only occasionally sells a Belwood Standard Kitchen. Apparently, persons who normally are prospective buyers for the standard line which Belwood produces decide to purchase a product made by one of the larger manufacturers.

In July of 1959, the sales manager resigned to accept a position with the Belwood representative in Little Rock.

Competitive Situation. Indications, according to Belwood's analysis, are that the potential market for quality kitchens is expanding. There seems to be a definite change in attitudes towards kitchens in view of the trend toward informality of family living, the increased use of built-in appliances, and the decline in the number of servants. A preference for the "living" kitchen, as contrasted to the old conception of the kitchen as a utility room, is growing. In entertaining, the tendency is for people to drift back to the kitchen and talk to the house-wife as she is preparing the meal. Such new attitudes, Mr. Moore believes, should result in a steadily increasing market for attractive, custom-designed, open-type kitchens.

Other economic and social trends, it appears to Belwood, will further stimulate the demand for fine kitchens. Home ownership, for example, increases as personal income rises. Housewives who can afford pleasant, efficiently designed kitchens will demand them just as the business executive demands pleasant and efficiently designed offices. In fact, the kitchen is used more than any other room in the home. From 18 to 25 per cent of the typical family's income is spent on food, and another 5 to 10 per cent on the operation of household appliances centered around the kitchen. It is logical, therefore, to expect the kitchen to be treated more and more like other fine rooms in the house and less and less, as has frequently been true in the past, like a crackerbox attached to the home.

Belwood is one of a half dozen manufacturers offering custom-designed kitchens with a wide choice of woods. Manufacturers generally offer finishes in only one wood, although with choice of various stains. One manufacturer offers maple in fifteen different stains. Most manufacturers, moreover, offer cabinets only in standard sizes. Advertised custom-designed deluxe kitchens frequently are merely a custom arrangement of standard units, with fillers used to eliminate open spaces.

The large manufacturers normally have a kitchen specialist in each large city handling their respective lines. They maintain factory trained personnel. Because the dealers are usually well established, competition with them is keen. In remodeling work, it has been the experience of

Belwood that customers usually go to a kitchen specialist rather than to an architect. Whereas an architect might specify a custom kitchen, the specialist tends to use standard sizes with fillers.

Custom-designed kitchens for homes costing less than $20,000 are usually constructed on the job by local cabinet makers. Unfinished plywood is used frequently, cut and assembled by the cabinet maker, and then painted or stained. Such installations cost about three-fourths as much as a precision kitchen constructed in a factory.

Perhaps the single best competitive advantage of Belwood Kitchens is that they frequently are specified by architects for houses costing above $30,000. The wide choice of designs and of woods makes it possible for the architect to reflect individual family personalities. Furthermore, doors on Belwood cabinets may be either sliding or hinged. No other firm operating within a radius of several hundred miles of Ackerman, as far as Belwood can determine, offers a competitive variety.

Pricing Policies. Under Belwood policies, pricing has been by the unit. Since specific job cost information has never been available, the usual policy is to price each unit on the basis of the estimated direct materials and labor cost. Such direct costs constitute two-thirds of the net sales price, thus allowing one-third to cover indirect costs and earnings.

Under this policy, Belwood's price for the custom-built Deluxe Kitchen generally runs from $900 to $2,000 f.o.b. Ackerman (excluding appliances). The higher range applies to large kitchens of mahogany and walnut and includes special-purpose units and sliding doors. This price tends to be about 10 per cent above comparable deluxe lines of standard sizes offered by the large firms. The Belwood Deluxe Kitchen therefore is selected by architects who are especially interested in design.

The typical Belwood Standard Kitchen, available in maple only, is sold in a price range between $600 and $1,500 f.o.b. Ackerman, depending on the number of units selected. This is competitive with prices of comparable units of the large manufacturers, but is higher than kitchens with steel cabinets or those produced by local cabinet-makers from unfinished plywood.

Prices for custom-designed furniture installations are calculated on the same basis as for the complete kitchen, with the direct cost of labor and materials serving as the base. The cost of the premium woods again accounts for nearly half of the selling price.

Discounts of 25 per cent are granted to dealers, the exact amount depending upon services performed. The maximum discount is granted only to those dealers maintaining a satisfactory display of the Belwood kitchens.

Personnel. Throughout the firm's history, Mr. Moore has served as president and general manager. The first program to develop a formal type of organization was started in 1958. Positions were established for a sales manager, an office manager, and a plant superintendent. The possibility of employing a personnel manager was considered, but it was decided that this function would continue to be performed by Mr. Moore and the Plant Superintendent.

For sales manager, Mr. John Kenney was employed. He was a young man in his mid-thirties with previous experience in selling air conditioning equipment. In less than a year, as mentioned earlier, he resigned to accept a position with The Gunn Distributing Company, the Belwood representative in Little Rock, where he re-entered the air-conditioning field. No one had been employed to replace him.

Mr. J. P. Hairston, a 1958 business administration graduate of Mississippi State University, came with the firm as office manager and general administrative assistant to Mr. Moore. He established an accounting system so that more exact information on direct labor and materials cost would be available. In addition, he acted as a salesman in showing model kitchens to plant visitors and handled much of the purchasing of supplies and materials. During his two years with the company, he has developed as a kitchen specialist with great enthusiasm for the future of the business.

Mr. John K. Stephens was appointed as plant superintendent. He was employed by Belwood when it first began operations in 1947, and had supervised all phases of manufacturing operations. He was a graduate of the Ackerman High School, and had obtained most of his experience with the Belwood organization. In controlling plant operations, he was considered exacting both in meeting specifications and in obtaining efficient production.

At full production, Belwood would need around 70 plant employees for a one-shift operation. In 1958 the maximum employment was 45, but this dropped to 25 to 30 during much of 1959. Ackerman is located in a surplus labor area with a number of skilled machine operators anxious to obtain work. One of the goals of the company is to provide as many jobs as possible. Men only have been employed, and no effort has been made to unionize the plant.

Future Plans. Basic decisions faced by Belwood, Mr. Moore believes, center around the problems of expansion. During the first twelve years of successful operation and steady growth, a manufacturing plant was constructed with a capacity of 750 Deluxe Kitchens per year on a one-shift operation. This represents a sales potential of over $1 million. Full utilization of the plant, therefore, would require a tripling in sales over that of 1959. Even further expansion could be achieved if a second shift were employed.

A program of expansion, it is recognized, would involve a number of related problems. Past earnings have been devoted to building the factory and equipping it with special purpose precision machines. Expansion of its sales program would require additional capital. If ten company-owned sales offices, for example, were opened in cities within a range of 500 miles, such as Atlanta, Baton Rouge, Dallas, Mobile, and Nashville, $250,-

000 would be needed for this purpose alone. Also an equal amount of capital would be essential to handle increases in inventory and accounts receivable.

A decision to expand raises the question as to whether emphasis should be directed to standard items or continued on the custom-designed Deluxe Kitchen. No organized survey designed to estimate the market potential for custom-built kitchens and furniture ensembles has been made. It appears to Belwood management that the continued growth in per capita income and increased level of education will stimulate the demand for custom-designed items for family living. Moreover, nearly 500,000 new homes are being built each year in the suburbs where emphasis is on informal living, frequently centered around the combination kitchen-family room. Pride in designs to reflect the individual tastes of the housewife should develop a further demand for the Deluxe Kitchen.

Informal estimates are that the typical homebuilder plans to spend ten to fifteen per cent of the cost on equipping the kitchen, including cabinets, appliances, and installation units. After making allowances for the stove, dishwasher, refrigerator, clothes washer and dryer, and other popular appliances, funds for fine cabinets are limited except in homes costing more than $20,000.

In the Southern states, about fifteen per cent of all new urban homes cost more than $20,000, although nationally the percentage is twenty. For Mississippi, the estimate is that about 400 new homes are built each year costing more than $20,000.[2] No specific information on the market potential for high quality kitchens in home remodeling is available. The assumption is that housewives in homes valued at more than $25,000 could well afford a custom Deluxe Kitchen.

By using new homes valued at $25,000 or more as a base, the theoretical market potential for the Deluxe type of kitchen would be 5,000 per year in Mississippi and the adjoining three states of Alabama, Louisiana, and Tennessee. A goal of ten per cent of these for Belwood, in view of the competition of other kitchen manufacturers and local cabinet makers, would require an intensive sales program.

In view of the recognized need for a greater volume of sales, Belwood is also exploring the possibility of a more competitive line for the less expensive homes. Designs were developed in 1960 for a "Front Line." This consisted of cabinet fronts, of standard sizes only, which could be used by home builders in conjunction with locally assembled boxes or interiors. Quality construction with hollow core doors, and a rich finish in maple, would tend to give the appearance of a Belwood Kitchen at about two-thirds the cost.

Whether there is a market for this item, or whether its sale would adversely affect the excellent reputation of the Belwood Deluxe line, are points on which a decision had not been made. Neither had a decision been reached about the possible market for standard, in contrast to custom-designed, special purpose ensembles for the bedroom, living room, and bath.

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[2] These estimates are based on data collected by the Bureau of Labor Statistics, but were calculated independently.

Other ideas which occurred to Mr. Moore included the possibility of selling through an independent sales agency, of manufacturing items for one of the large kitchen cabinet companies, or of providing cabinets and appliance installation units for an appliance manufacturer desiring to sell completely equipped kitchens. An independent sales agency, which would take over all functions of advertising and selling the Belwood line, on a regional or national basis, if such an agency could be interested, would seem to offer a profitable distribution channel. No steps, however, had been taken to interest any particular company.

In making final decisions on future policies, Mr. Moore indicated that a basic goal was to have the company continue to grow so that a greater contribution could be made to the economic development of Ackerman as well as provide economic security for his family. Many citizens of Ackerman and its trading area were keenly aware of a need for industrial expansion in order to complement the limited opportunity for further agricultural development. Only two other factories, the Ackerman Manufacturing Company producing work shirts, and the Ackerman Planing Mill, operated in the county, although construction of a plant of the Endicott-Johnson Shoe Company was scheduled to begin in the latter part of 1960.

The modern kitchen business, Mr. Moore feels, is a young industry, just beginning to grow, and offers great future opportunity. Technological developments and improved designs should cause the kitchen to become the center of family life. The future kitchen-family room, with its island areas for cooking, eating, TV, and other household activities, can provide both a pleasant atmosphere with year-round air conditioning and an efficient work place. Thus once again, as was true during the days of our Pilgrim fathers when activities centered around the open fireplace in the kitchen, the entire family will be together more.

New products, designs, and ideas for the modern kitchen are coming out all the time, and Mr. Moore emphasizes that only the manufacturer can effectively test them and make the best available to the housewife. Moreover, the local or regional manufacturer is in position to provide individual service, especially on custom-designs, more satisfactorily than the large manufacturer who must produce standardized items in volume.

Against ideas for expansion is the recognized possibility of continuing operations under past policies. Belwood has been reasonably successful, and could continue to provide custom-designed kitchens to its limited market. Its excellent reputation for specialized service means that many architects throughout the South undoubtedly would continue to specify Belwood Kitchens in fine homes.

EXHIBIT 4

BUILDING PERMIT ACTIVITY IN SELECTED STATES
NUMBER OF NEW DWELLING UNITS (URBAN)
(Housekeeping Units Only)

	1953	*1954*	*1955*	*1956*	*1957*	*1958*	*1959*[1]
U.S. total		1,074,512	1,148,488	943,199	848,020	1,002,776	1,122,825
Alabama	7,301	12,473	13,442	12,344	13,056	19,251	18,401
Arkansas	1,748	4,157	4,237	3,726	3,706	4,389	4,112
Florida	42,851	48,887	53,069	58,144	63,050	64,175	65,969
Georgia	13,920	20,976	19,668	16,355	14,952	18,251	21,332
Kentucky	3,875	10,823	13,127	9,039	7,681	9,253	10,593
Louisiana	9,861	13,645	14,552	11,532	11,269	15,231	15,932
Mississippi	2,668	4,262	3,694	2,919	2,648	3,039	3,886
Missouri	14,636	16,355	17,180	13,161	10,845	17,246	20,535
Ohio	44,624	54,680	60,588	51,215	43,013	48,250	54,034
South Carolina	2,821	4,790	5,351	3,945	3,265	3,478	4,112
Tennessee	12,090	16,084	16,836	11,540	9,954	14,248	17,120
Texas	48,870	68,478	69,214	45,543	49,602	69,942	68,400

Source: Construction Review, U.S. Department of Commerce and Bureau of Labor Statistics, *New Dwelling Units Authorized.*

EXHIBIT 5

BUILDING PERMIT ACTIVITY: NUMBER OF NEW DWELLING UNITS IN SPECIFIED METROPOLITAN AREAS

	1951	*1952*	*1953*	*1954*	*1955*	*1956*	*1957*	*1958*	*1959*
Atlanta, Georgia	9,380	8,722	8,940	12,539	11,521	9,485	7,630	10,337	12,770
Birmingham, Alabama	3,870	3,569	3,437	4,752	5,314	4,087	4,603	6,649	7,203
Cincinnati, Ohio	7,606	5,805	6,258	6,725	6,436	6,424	5,786	6,921	
Columbus, Ohio	3,577	3,987	5,238	7,291	7,642	6,988	5,326	8,967	7,888
Dallas, Texas	8,576	9,243	8,485	14,400	15,681	8,014	8,734	13,483	
Houston, Texas	9,911	10,081	9,526	11,302	8,868	6,355	11,244	14,618	
Jackson, Mississippi	691	563	741	1,006	855	585	401	587	699
Little Rock, Arkansas	1,159	880	798	1,030	1,120	991	917	1,078	
Memphis, Tennessee	5,857	8,183	6,563	6,962	6,854	3,994	3,749	6,186	
Miami, Florida	12,589	15,240	17,167	16,361	17,131	18,387	18,761	15,794	
Mobile, Alabama	745	1,237	675	1,200	1,263	1,498	2,298	3,406	
New Orleans, Louisiana	4,793	3,510	4,916	5,201	5,888	4,539	4,334	6,114	

Source: Construction Review, U.S. Department of Commerce and Bureau of Labor Statistics, *New Dwelling Units Authorized.*

EXHIBIT 6

Estimated Values of New Nonfarm One-Family Homes
(Percent of Total)

	*Financed by FHA**		*Estimates for All Homes —1959*	
	1959	*1960 1st Quarter*	*U.S.*	*South*
Less than $10,000	3.7	2.9	12	24
$10,000 to $14,999	55.6	53.7	40	42
$15,000 to $19,999	34.2	37.0	27	18
$20,000 to $24,999	6.0	5.9	18	14
$25,000 and over	0.5	0.5	3	2

* Estimated price that typical buyers would pay. Calculated from Federal Housing Administration data.

† Calculated from Bureau of Labor Statistics data.

part III

CONTROL

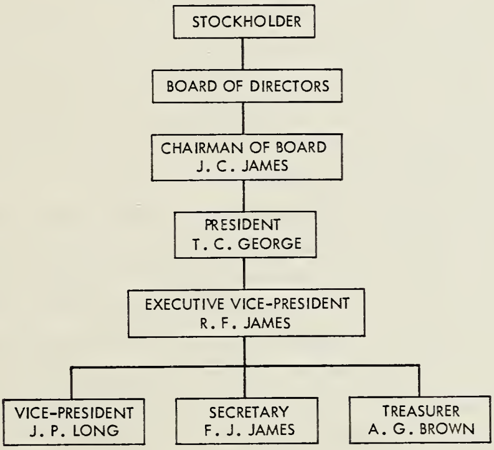
Barcelona Insurance Company (A)[*]

The Barcelona Insurance Company[1] is a medium-sized, profitable concern located in one of the largest cities in Louisiana and incorporated under Louisiana laws. The company is largely owned and controlled by four families. In addition to the home office, there are 12 district offices located throughout the state. There are approximately 25 employees in the home office in addition to the six officers, while there are approximately 225 field personnel operating in and out of the district offices.

During the summer of 1959 a meeting of the officers of the company (See Exhibit 1 for the organization chart) was called by the chairman of the board of directors. The group met in the chairman's office with the following people present: Mr. J. C. James, chairman of the board of directors; Mr. T. C. George, president; Mr. R. F. James, executive vice-president; Mr. J. P. Long, vice-president; Mr. F. J. James, secretary; Mr. A. G. Brown, treasurer; and Mr. Pete Cassity, an outside consultant. Prior to the meeting, Mr. Cassity had obtained the following information.

EXHIBIT 1

Organization Chart, 1956–59



The Management of the Company

Mr. J. C. James is about 65 years of age, is married, and has two grown daughters. He entered the insurance business when he was about 21 years of age and had been an agent for a national company 10 years when he helped organize the present company. Although he did not graduate from college, Mr. James' lack of formal education, according to one executive, has been more than compensated for by his informal education and training. According to another executive, "He has a keen mind and a very retentive memory." He still takes an interest in professional, civic, and religious activities. At the present time, Mr. James would be classified as conservative in his business beliefs. He is in no way retired from the company.

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[*] Prepared by Leon C. Megginson, Louisiana State University.

[1] All names have been disguised.

Ted George is in his early forties. He studied mathematics in college, receiving a B.A. degree from a denominational school in Mississippi. He came to work for the company immediately after graduating in 1937 and has had no experience with companies other than Barcelona Insurance. He is married and has three children. During World War II he served as a navigator with a heavy bomber squadron in Europe. He is strictly an extrovert with the typical salesman's concept that the world is a wonderful place in which to live and tomorrow will be better than today. He is very personable and easily makes friends with nearly everyone he meets. Mr. George's mathematical training has put him in good stead, for he is able to analyze critically a group of figures and arrive at a logical conclusion based upon them. He is a deacon and Sunday school teacher in one of the Baptist churches in the area. He has served in many civic capacities but probably his greatest contributions have been in the professional fields where he has been very active.

Bob James, the executive vice-president, is in his late thirties. While in college, he studied Business Administration and received a B.S. degree in that field in 1941. He entered the company the same year and served there until he was called into the service a couple of years later. He is a veteran, having served as an officer in the Navy. Married, and the father of two children, he is very active in his church activities. He has served as chairman on the board of stewards of the Methodist church. In addition to his church work, he is very active in civic affairs, particularly the YMCA. Professional organizations also receive a great deal of his attention. A man of vast energy, he is a very likable, happy-go-lucky person, with a great deal of capabilities. He is the extrovert, salesman type of individual who would be classified, from the economic point of view, as a liberal with a great deal of desire to change things. Mr. James came to work for the company immediately after graduating from college and has no experience with any company other than Barcelona Insurance.

Mr. J. P. Long was too young for World War I and too old for World War II. He is in his late fifties, is married, and has two grown children. Although he did not graduate from college, one of the company executives has said, "He graduated from the college of experience." He is a member of the Presbyterian church and has been relatively inactive in civic affairs during recent years. He holds membership in professional organizations, but has not been too active in an official capacity in any of them. It has been said that he cut his adult teeth on insurance, and that he has been in it all of his adult life. He came to the company from a national company in Jackson, Mississippi, in 1935. After serving 10 years as an agent and manager, he was promoted to vice-president in 1945. He would probably be classified as a conservative who would not be one of the first to try the new nor yet the last to lay aside the old.

Fred James, Bob's brother, who is the secretary of the company, is married and has four children. He finished with a B.A. degree from State University, where he majored in journalism. His forte is a flair for writing and for words and ideas. He is in his early forties and is active in the Methodist church. He has been exceptionally active in civic affairs, particularly in the Chamber of Commerce, the Salvation Army, and the YMCA. Although he maintains his membership, he has not been too active in holding offices in professional organizations. During the war he was in the Army; he served as a noncommissioned officer in the South Pacific. He has no work experience outside the company. Mr. Fred James would be classified as a conservative. He has a pleasing personality, but does not have the drive and initiative of his younger brother. He would be considered very capable with words, ideas, and with details.

Art Brown, who is in his late forties has spent his life in the insurance business. He received a B.S. degree in Business Administration from State University in 1932; in 1934 he entered the insurance business as an agent for one of the national companies. Because of the opportunities offered by the Barcelona Insurance Company, he joined the company in 1942 as an agent. He was called into service in 1943, and served as an officer in the United States Navy in the South Pacific. He is married and has one daughter. His home originally was in north Louisiana. Mr. Brown tends to be a conservative, has a good head for figures, and is good at analyzing. He is extremely honest and capable, with a high degree of integrity that has earned for him the respect of his fellow man. He is a deacon and Sunday school teacher in the largest Baptist church in the area. During recent years he has been very active in civic affairs and is a member of several organizations. He has also been active in professional organizations. Now he is beginning to devote more time to fishing and less to civic and professional activities.

Although four of the six top officers are members of the families that are the two principle stockholders, they have each had to work for their positions; these positions were not handed to them on a silver platter. Secondly, they had to begin their careers with the company in the field as agents before becoming officers. This is also true of all executives of the company.

The Meeting

As soon as the pleasantries of the day were exchanged, the chairman called the meeting to order and said:

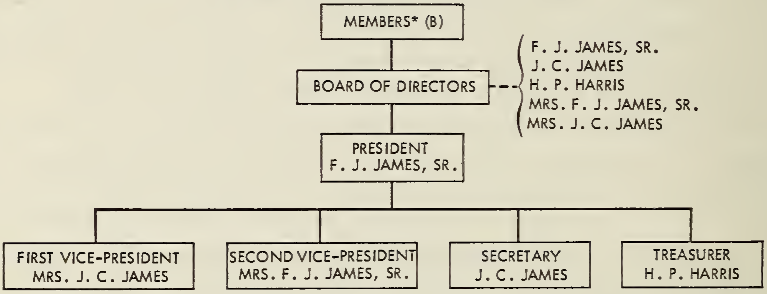
Gentlemen, we have an important series of decisions to make. The time has come for us to decide whether to expand our operations outside of the state of Louisiana. If we decide to expand, we then have a question concerning what additional state or states to go into. Further, what specific areas within the states to go into and the extensiveness of our operations. Finally, what effect will these decisions have upon our management personnel.

Before making these decisions, I would like to bring you up to date on the history of our company so that you can better understand the thinking that must go into making these choices.

During the mid 20's, my brother, Fred, Percy Harris, and I were working for another insurance company.[2] We began being dissatisfied with our situation and decided we would like to go into business for ourselves, for we had the desire to become independent and to be free of the shackles of working for someone else. If we were going to make anyone rich with our efforts, we decided that it might as well be us as anyone else. Also, we had the desire to make more money than we were making serving as salesman for the other company. These facts, coupled with the desire to "be on our own" induced us to make the break and organize an insurance group of our own. Therefore, we organized Barcelona as a mutual company with $5,000 capital and with a one room office in one of the downtown office buildings. [See Exhibit 2 for the table of organization.] We were the only employees of the company for several years; consequently, we had to do all the field work as well as the clerical work. I will never forget the excitement when Fred wrote the first application for the company. However, this enthusiasm was dampened a little when we had to sit down and type the policy ourselves. We were writing only one type of policy at that time, that is, a health and accident policy. The only major difficulty we encountered was the harassment by the major companies whose salesmen were telling our policy holders that we didn't have any money, that we wouldn't be in business for six months, that we were a fly by night operation, that we could not legally write a policy outside of the city limits, and doing everything but insulting our character and integrity. (Sometimes I think they even did that.)

EXHIBIT 2*

ORIGINAL ORGANIZATION CHART, 1926



* Company was nonstock corporation, composed of members holding certificates in accordance with the mutual assessment plan.

Under the mutual arrangement, we were carrying on a business of selling industrial life insurance, where the stipulated premium and advance assessments were regularly payable and collectible every week, or for any other time period up to four weeks. We were organized as a nonstock corporation, that was based upon members holding certificates in accordance with the mutual assessment plan. We were selling only one policy, that is a Class A policy which included life insurance combined with the weekly indemnity figure for sickness and accident. We started operating with 15 members.

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[2] Mr. J. C. James is the uncle of Fred and Bob James and T. C. George. Fred and Bob are the sons of F. J. James, Sr.; T. C. is the son of Mr. J. C. James' sister.

Our business was progressing nicely when we had during the year 1927 the worst flood we have ever had. Unfortunately, in addition to doing serious damage to the city and surrounding areas it also adversely affected our business so that our sales of policies and collection of premiums were considerably slowed down.

By 1928, the company looked like it was going to be successful and the mutual idea was becoming less desirable, so we decided to incorporate as a stock company. We surrendered our old charter and reinsured the mutual business in the stock company.

When we incorporated as a private stock company in 1928, there were 15 share holders and the capitalization was $10,000 composed of 100 shares of nonassessable stock with a par value of $100. There were five members of the board and three officers.

Things were going nicely until the stock market crashed in October, 1929. Then, the depression really started and things began to get tough for us and our new company. As did all other business organizations, we had a hard time collecting money; as a matter of fact, sometimes we almost did not collect enough money to pay our claims to the policy holders, which would probably have made the larger companies happy. Also the depression caused some of our policy holders to turn their insurance into an investment rather than a form of protection.

Things had become so rough by 1931 that Fred accepted a position with a national company in Jackson, Mississippi. At that time, I was made President of the company and began the unpleasant task of trying to consolidate and save the business that we had. These were strictly times that tried men's souls. To try to make ends meet, Mr. Harris and I remitted $10 a week, each to the company, even if it had to come out of our personal money. Mr. King (one of the stockholders who was also selling for us) was on a different basis. After paying all of his claims and his salary he was to remit to the company the remainder of his premium collections. By these two means, the company showed a profit of around $900 at the end of 1931.

From there on, things got worse. At the end of 1932, we didn't have any money. Mr. Harris and I had to put up money which we raised by mortgaging our houses, before we could file the annual report with the state Insurance Commissioner. In the latter part of 1932, Fred came back and was put on the same contract basis as Mr. Harris and I were on. By doing this, we had $30 a week definitely coming in; Mr. King was giving us a pretty good profit from his debit. That is the way we finally pulled things out and saved the company.

In retrospect, I have to laugh at our brashness and perseverance. In the early part of 1932, we were definitely broke and would have sold the company if we could have found a buyer for it. We tried to sell the stock in the company, but people would only laugh at us and not buy.

I have been asked what factors have contributed most to the success of our company. It seems that the following factors pulled us through. First, there was the desire we had to be on our own, to be independent of outside control. Second, there was our determination to succeed—in other words, pure stickability and the desire to show our detractors that we could succeed. Third, there was our ambition to create a successful company to leave for our heirs.

Fourth, there was our hard work, as exemplified by our getting out and beating the bushes for 16 to 18 hours a day, because we could not afford the luxury of paid employees in those days. Fifth, there was plain "good management" or the ability to operate the company successfully. Sixth, there was our desire to make money.

By 1935 we hired two agents who had been with a national company for a long time. They were very good agents and soon built two good debits for us. One of these men is still with us, while the other one has retired. J. P., you were one of these men.

Ted, do you remember when you came with us in 1937? You were fresh out of college and were eager to set the world on fire. We turned you loose and you did.

The following year we made our first move outside of our town. It was during this year that we finally reached a $1,000 per week debit.[3]

The year 1939 was a good one for us. Fred, you joined our group and we sent Ted to open up District Two.

The year 1940 was a year of progress but it was tempered with sorrow, for Mr. Harris died during the middle of the year. However, earlier we had opened up District Three and were continuing to grow very rapidly.

The next year was also a year of sorrow because Fred, Sr., died during the early part of the year. Following his death, you came with us, Bob. That year was the beginning of World War II and our boys started leaving for the service.

The following year was a good one for us—in a way. Ted enlisted in the Air Force, after he had opened District Four. However, offsetting this was the fact that you came to work for us, Art, but your time with us was very short, because you were called into the service in 1943.

In that year, Fred opened up District Five. But, we were having a very difficult period again because two of our key men died and because so many of our other men were going into service. Up until then, we had been trying to build an organization of young men. During that year, we increased our capitalization to $40,000; Mr. King was made Treasurer.

The war years, while not being as severe on the company as the depression years, were very trying. Instead of the young organization that we had been building, it had become a middle aged organization. Also, much of our time, particularly mine, was spent on the road, and this was made doubly difficult with the shortage of gasoline and tires and the inconveniences of travel facilities in those days. Also, anyone we hired had to be trained and we were very likely to lose him anyway.

In 1945, you boys started coming back from the war and things began to assume a semblance of normalcy again. That was a momentous year for us in another respect; we reached a $10,000 weekly debit.

In 1945, while you were still in the service, you were elected Executive Vice-President, Ted, and you, Fred were elected Secretary.

During the war years Mr. King was in bad health because of a heart condition. In 1946, he died and Art was made Treasurer. You, Bob, were made Vice-President. [See Exhibit 3 for the organization.] That year saw other momentous changes for we opened up Districts Six, Seven, and Eight.

Business was increasing so rapidly that we could no longer operate out of the existing office space, so we started making plans for a home office building in 1947. The following year we bought the land for the building, on one of the main streets of the city. In December of that year, we broke ground for the home office building and moved in during the following year.

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[3] A $1,000 per week debit means that $1,000 is received in premiums from the policy holders. This is equivalent to a $52,000 per year income.

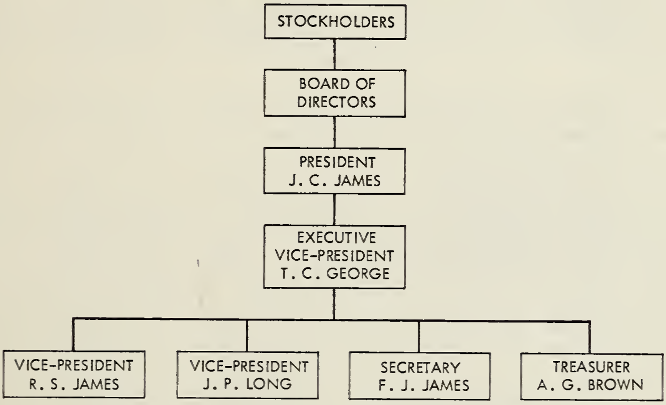
The years 1950 and 1951 were profitable and we were able to open up three new districts, that is, Districts Nine, Ten, and Eleven.

By 1953 business had improved so that we were able to increase our capitalization to $500,000. After Fred's death his share of stock went to his family and following Mr. Harris's death his shares went to his family. At the present time, 61 percent of the stock is owned by my family and Fred's family, while 33 percent is owned by the Harris family. The balance is owned by the officers of the company and a few outsiders who invested in the company during its earlier period and who had faith that it would succeed.

In 1954 our charter was amended so that we were permitted to operate in any state in which we received authorization to do business.

EXHIBIT 3

Organization Chart, 1946–56



You will remember that my desire to become less active in the business, as well as give you younger men more of a chance to use your abilities, led us to reorganize the company in 1956. [See Exhibit 1 for this organization.] I became the Chairman of the Board of Directors while Ted became the President of the company, and, Bob, you were made Executive Vice-President.

The years have been good to us as shown by our annual reports for the last two years, and the estimated report for this year. [See Exhibit 4.] We have a very good organization, and although it is about middle sized for operations of this nature, it is sound and profitable.

Now we are at a cross road. I've always had the idea that we would never leave Louisiana but would continue to do business within its confines. The business is currently exceptionally well managed, and we can continue to make very good profit and to progress without too great an effort by operating only within our home state. If we keep the business consolidated we will make more money out of it. There is a whole lot of difference between building a business and getting new business now and 25 or 35 years ago. Today, it costs a whole lot more money.

Now, we have just blanketed the state. There is no chance for creating any new district unless we subdivide some of the existing ones. Nevertheless, we can continue to increase the business in each one of the districts, and we can try to obtain the business of increasing population within our own state.

Over the years we have emphasized the accident, health, and industrial type policies based upon the weekly payment of premiums. That way the agents built up a good working relationship with the policyholders as well as being very profitable. Our experience is based upon this method and therefore is one of our most valuable assets. This form of business is based upon the concept of building the business fast and then consolidating your gains as soon as possible. We have usually had a debit on a paying basis in one year.

EXHIBIT 4

Comparative Income Statements, Barcelona Insurance Company, 1957–59

	1957	*1958*	*1959**
Premium and annuity consideration	$ 2,552,589	$ 2,709,014	$ 3,010,502
Industrial life	1,255,565	1,287,891	1,406,730
Ordinary life	78,107	123,864	140,449
Accident and health	1,216,099	1,291,936	1,457,272
Total Income	$ 2,677,345	$ 2,852,596	$ 3,154,785
Total Expense	2,365,490	2,395,556	$ 2,872,876
Net gain	311,855	457,040	281,909*
Ordinary Life			
Number of policies beginning of year	1,014	1,333	1,495
Amount of policies beginning of year	$ 4,309,322	$ 6,583,724	$ 6,938,269
New business during year			
Number of policies during year	815	601	793
Amount of policies during year	$ 4,847,154	$ 3,063,082	$ 3,833,928
Policies terminated during year			
Number of policies during year	496	439	339
Amount of policies during year	$ 2,572,752	$ 2,708,537	$ 1,653,200
Amount end of year			
Number of policies end of year	1,333	1,495	1,949
Amount of policies end of year	$ 6,583,724	$ 6,938,269	$ 9,118,997
Industrial Life			
Number of policies beginning of year	189,084	192,050	193,748
Amount of policies beginning of year	$36,644,201	$38,568,373	$41,707,875
New business during year			
Number of policies during year	88,051	89,558	84,257
Amount of policies during year	$23,274,994	$23,707,802	$29,593,354
Policies terminated during year			
Number of policies during year	86,331	87,860	78,982
Amount of policies during year	$21,543,434	$22,568,300	$23,814,250
Amount end of year			
Number of policies end of year	192,050	193,748	199,023
Amount of policies end of year	$38,568,373	$41,707,875	$47,496,979

* Figures estimated. According to the treasurer, the new Federal Income Tax law would cost the company approximately $100,000 per year and the company would have to pay two years' tax in one year.

Now we are contemplating changing this concept of operating by moving into another state and changing the emphasis on the type business we sell. We would sell the family type plan that would be paid on the monthly basis. Also, we would emphasize the ordinary life type policies that we have not emphasized in the past.

I would like to hear the ideas that each of you have on the subject. First, as Treasurer, Art, what are the reasons that you can see for us staying in Louisiana and operating here.

A. G. Brown, Treasurer: One of the reasons we should stay here is because of the relatively low overhead at the present time. If we open up another state on an extensive scale we will have to increase our overhead expenses. This is particularly true if we open up a state office on an extensive scale. Second, we now have low operating costs as a percent of income. If we expand into another state, this figure will increase if we hire many supervisory and managerial personnel. Therefore, our operating costs per dollar of sales will increase. All in all, during the short pull, we will make more money by staying in Louisiana.

CHAIRMAN J. C. JAMES: Thank you, Art. Now, J. P., speaking as Vice-President, what do you think of us remaining in the state of Louisiana and restricting our operating to the one state?

J. P. LONG, VICE-PRESIDENT: Well, Mr. James, I can see where we will have fewer regulations governing our operation by remaining here. If we enter some other state, we will probably be included under federal jurisdiction. Also, it seems that we will have easier supervision and control over our personnel here in the one state. Just the sheer volume of traveling, whether it be by car, train, or plane, will take a tremendous amount of the time of the officers of the corporation, as well as being expensive. If we operate in another state, we will have a different set of rules and regulations pertaining to such things as workman's compensation, unemployment insurance, and so forth. As it is now, we are in the position of not being too much of a thorn in the side of the national companies.

J. C. JAMES, CHAIRMAN: Thank you, J.P., for your ideas. Now, Fred, as Secretary, will you give us the benefit of your thoughts on this important matter?

F. J. JAMES, SECRETARY: Well, I see the following reasons for staying in Louisiana exclusively. First, it will cost a terrific amount of money to open up a territory in any other state. It will probably cost us between $50,000 and $75,000 during the first year of operations in addition to the excess of premiums received over claims paid out. During the first two years it will probably cost between $100,000 and $125,000 to open up another state. We could take the money that we would spend in another state and spend it here in Louisiana for expansion and further development. By this method, each dollar would bring in more dollars of business than it would in another state.

Over the years we have evolved a set of rules, or fundamental principles that we have followed and we have been successful. These rules include going into an area on a limited basis trying to sell the business as quickly as feasible and then consolidate our gains. Now, we are proposing to change our way of operating. We have a good, good, set up here in Louisiana; why rock the boat at this time?

J. C. JAMES, CHAIRMAN: Thank you, Fred, for those thoughts. Now Bob, what are your ideas as Executive Vice-President?

R. F. JAMES, EXECUTIVE VICE-PRESIDENT: Although I am in favor of expanding operations into another state, I can see some possible disadvantages. One of these is that we would have to create the position of State Manager rather than having another District Manager as we currently have. In turn, we would have the problem of who would become the State Manager, whether one of us, one of our present district managers, or whether someone else should be assigned this responsibility. There is also the problem of obtaining qualified agents in these areas. As you know, our turnover among agents at the present time is about 67 percent per year. Obtaining, training, and retraining the large number of personnel for the new state activity would be quite a chore for the person who would become responsible for the operations. I estimate that it will require around 20 people, on an average, to run the state office and to service the debits as agents during the first year. Also, there would be the problem of sales promotion and advertising. To break into a new state would require a large outlay for advertising expenses if we hoped to go in on any kind of large scale operations. There would probably have to be a new pay basis for the agents in the new territory rather than the same basis that we have now. Although I envision that they would be on a commission basis just as our agents are at the present time, we would have to have a different basis of payment, at least during the initial period. Although I realize that this will not be an insurmountable problem, it must be taken into consideration.

J. C. James, Chairman: Thank you, Bob, I am sure that we will take into consideration the thoughts you have expressed. Well, Ted, can you think of any valid reasons for our staying in Louisiana, or are you firmly committed to the ideas of expanding?

T. C. George, President: Thank you, Mr. J. C. Yes, I am committed to the desirability of expanding operations into another state. However, I can see some possible difficulties. If we decide to expand, the next question would be into what state should we go? Also, in what city in that state should we begin our operations? Then, there is the problem of integrating the activities there into our activities here so that we will have one smooth running operation rather than two independent autonomous organizations—as we will have if we are not careful. As you so well put it earlier, there will be the large expense in opening up another state. It will probably cost as much, or more, to begin operations in another state, as it did to open up this entire state—for the cost of doing business has increased tremendously since you organized the company. And I realize as the rest of you do that all of us will have to do a tremendous amount of traveling to open up the new territory. However, if we are going to build up Barcelona into a sizeable organization, we cannot do it on a one state operation. . . .

J. C. James, Chairman: Whoa! there Ted! I asked you for some possible reasons why we should stay in Louisiana, not your arguments for why we should go to another state, and change our method of operating. To summarize, my personal philosophy has been to stay within the one state, to keep the business consolidated and therefore, to make more money that way. I wanted to stay in Louisiana because I have seen other companies remain here and have kept their businesses consolidated and they are making tremendous profits. I have seen other companies expand too rapidly and fail. The cost of opening new territories is very expensive now, and is almost prohibitive. There would be many personnel problems including the one of supervision and control of personnel in addition to finding, training, and keeping new personnel.

However, I don't want to prejudice your positions too much so let's see what your arguments are on the other side of the picture. Then, when I relinquished the presidency to you three years ago, I told you that I would let you really run the company without me dictating to you. This idea is your baby, so why don't you give us the benefit of your thinking at this time?

T. C. George, President: Well, as I said previously, if we are going to build Barcelona into a sizable company, we can't do it on a one state basis. If a business firm tries to stand still, and/or rest on its laurels, it is actually moving backwards. This principle is true because nothing involving human beings can remain dormant—it is either growing or dying, progressing or regressing, advancing or receding, improving or declining; there is no remaining still. The law of change governs all living things and all human institutions. They cannot stand still; therefore, if we are to be a progressive company and are philosophically so inclined, we must expand or we will begin to die as a business.

The men working for us will have more chance for advancement by opening up new territories. By staying in this state, we will not be able to have any more district managers because we have covered the state already, and the state can't stand any more districts. Consequently, in order to give the men the opportunity that they should have, we must expand. Therefore, the opening of the new territory will provide fields for advancement for our personnel in the future. Four years of operations without a change in management is a dangerous thing for the company. It is foolish to let an arbitrary boundary line stop us when we ought to be concerned more about the expansion of the business.

We can handle operations in another state and not have to add any additional personnel to the home office at the present time. You realize, of course, that we have had considerable experience in opening up new territories as each one of us at one time or another had to open up a new district in the state.

Another thing that enters the picture is the new tax law that is contemplated and is almost assured of passage by Congress. It looks as though we are going to be better off spending money for expansion than accumulating it and paying it to the government. It is estimated that our taxes on profits this year will go up from $15,000 to about $100,000, and this will continue to increase as we make more profits. The way I see it now is to continue our expansion so that we will bring in more dollars of income and so that we will have more money to pay the taxes.

If the company is to grow it must expand; if we are to expand, it is inevitable that it must be in another state.

J. C. JAMES, CHAIRMAN: Thank you, Ted, for your argument. Art, do you have anything to add?

A. G. BROWN, TREASURER: Yes, I do. It seems that this expansion will give us a better plan to sell to the men who are coming with us in the future, as well as those already with us. It is hard enough to attract men into the industry as agents, but it would be a little easier if we had an expanding company with the possibility of the creation of new districts to offer to them as an inducement.

J. C. JAMES, CHAIRMAN: J.P., do you have anything to add?

J. P. LONG, VICE-PRESIDENT: As Art mentioned, we need to give more prestige to our personnel and this can only occur if we become larger. We can also provide better service to our policyholders in this manner. But will this compensate for the drain on the company's cash position? Also, we have been operating on the weekly premium industrial basis, primarily. If we change over to the monthly premium and sell the ordinary type of policies, will we be able to change successfully our thinking and operations to cope with the new problems?

J. C. JAMES, CHAIRMAN: Thank you, J.P. Fred?

F. J. JAMES, SECRETARY: Well, we made a substantial increase in our profits last year, and it looks like we will again; also, there were considerable increases in nearly all phases of our activities. I still do not think it is good to rock the boat. However, it seems that the question we have to resolve is the balancing of the advantage of the long term opportunities this move will create for our personnel against the disadvantage of the increased cost of operations in the short run.

J. C. JAMES, CHAIRMAN: Bob, how about you? What is your thinking concerning the advisability of expanding into another state?

R. F. JAMES, EXECUTIVE VICE-PRESIDENT: I can't help but think of our children—and your grandchildren, Mr. J. C. What kind of a business are we going to leave for them when they become old enough to either enter the business or to rely upon it as a source of income? What kind of a legacy are we going to leave for them?

J. C. JAMES, CHAIRMAN: Thank you, Bob. Before we decide what our course shall be, let me add this further thought. We are faced with the choice of committing ourselves not just a little bit more, but of going in deep; not investing just a little more money. The company is in a certain stage in its development where it is not a simple problem of moving ahead but of taking a great leap that has many dangers, for we will be engaging in some activities that are quite different from those previously performed. Our units of growth until this time have been the individual policyholder, then the debit, then the district, but now we are committing ourselves to a whole state.

Also think of the corporate image that our personnel, policyholders, and the public has of us. This will be changed if we leave the state.

We also have a responsibility to our policyholders. Back in 1932, we could take chances, but now we have a greater responsibility to them.

Barcelona Insurance Company (B)[*]

The officers decided to recommend to the board of directors that operations be expanded into another state. (See Barcelona Insurance Company [A].) This was passed by the board and approved by the stockholders. The next question to be decided was in what state or states should the company begin its expanding operations. The president of the company made these observations:

> Our original plans were to open in the state of Texas. We had been advised many years prior to this time that we didn't have to worry about similarity of names and that we could add "of Louisiana" to our name and qualify in any state. However, the Texas Insurance Department would not permit us to enter the state because there was another company by the same name operating there. After being thoroughly convinced by the department and their legal staffs that we could not enter that state, it became necessary for us to reach further decisions concerning the company's expansion.
>
> We decided to become licensed in as many southern states as possible in order to keep from being blocked at a later date from entering those states because of the similarity of names. In accordance with that decision, we made preparations for simultaneous licensing in Arkansas, Mississippi, Alabama, Tennessee, Georgia, Florida, and South Carolina. In Georgia and South Carolina, there is already a Barcelona Insurance Company so we were blocked from being licensed in those two states. We were immediately licensed in Arkansas, Mississippi, Florida, and Tennessee. The application in Alabama is still in the pending stage because back in the early 1930's a Barcelona Insurance Company was formed in the state but later its business was reinsured by another company. Therefore, Alabama has not agreed to license us. It should be emphasized that neither have they completely rejected our application, so we are constantly keeping a look out in that state and have contacts open to see if we can receive permission to operate there. Also we are keeping a constant watch on The Barcelona Insurance Company in Texas and the Barcelona Insurance Company in Georgia and South Carolina. Should there be a change in their status, we will proceed immediately to be licensed there. It is rather expensive to be licensed in those states, as we have to pay the annual license fee and taxes even though we are not operating there.
>
> As we were licensed in the four states, we had to decide in which one we would start our first expansion.

The president then explained that an extensive study had been made of the economic, social, political, and other aspects of the four states so that the most logical conclusion would be reached. The executives investigated such questions as the number of large towns in each state; the economic situation, particularly as the decision had to be made during a recession year; the climate, especially what is the condition during the winter months; and the proximity of the states to Louisiana, including the fact that both Mississippi and Arkansas could easily be served from districts in Louisiana. If the expansion were in Arkansas or Mississippi,[1] there would not necessarily have to be the appointment of a state manager or even the creation of new districts, for "we could enter these two states through a gradual expansion of our Louisiana offices that are bordering these rather than going to the expense of creating new districts, new district managers, and the hiring of new personnel immediately; we would just expand our present organization as the need arose. For sentimental reasons, we gave special consideration to the state of Mississippi as all of us were originally from there and as we still have relatives there."

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[*] Prepared by Leon C. Megginson, Louisiana State University.

In addition to the information mentioned above, the material included in Exhibits 1–13 which showed the past growth of the states was considered. The type of people was also important, for the company was engaged primarily in the selling of industrial insurance on the weekly or less than monthly basis of payment. The reaction of the people to an outside corporation coming in to sell this type of service also had to be considered along with the potential source of personnel for a company.

If you were acting in the capacity of a consultant, what state would you advise the president to consider for the initial expansion into interstate operations?

EXHIBIT 1

TOTAL ASSESSED VALUATION OF PROPERTY, SUBJECT TO STATE AND LOCAL GENERAL PROPERTY TAXATION, 1956
(Gross, before Exemption, Millions of Dollars)

Arkansas	$ 934
Florida	6,858
Louisiana	2,937
Mississippi	1,296
Tennessee	2,974

Source: U.S. Department of Commerce, *Statistical Abstract of the United States*, 1959, p. 416.

EXHIBIT 2

VALUE OF CONSTRUCTION CONTRACTS AWARDED, 1950–58
(Millions of Dollars)

	1950	*1958*	*Percentage Increase, 1950–58*
Arkansas	$126	$ 234	86
Florida	532	1,431	169
Louisiana	311	678	118
Mississippi	103	225	118
Tennessee	397	477	20

Source: U.S. Department of Commerce, *Statistical Abstract of the United States*, 1959, p. 756. (Percentage increase computed from the above figures.)

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[1] If the company entered Mississippi it would be required to maintain an additional reserve of $162,000.

EXHIBIT 3

Population Characteristics, 1950–58

	Arkansas		*Florida*		*Louisiana*		*Mississippi*		*Tennessee*	
	1950	*1958*	*1950*	*1958*	*1950*	*1958*	*1950*	*1958*	*1950*	*1958*
Total number of persons (thousands)	1,905	1,766	2,821	4,442	2,699	3,110	2,170	2,186	3,303	3,469
Percentage Increase 1940–50	2		46		14		0		13	
Percentage Increase 1950–58										
Population per square mile, 1950	36		51		59		46		79	
Percentage of population living in urban area, 1950	33		66		55		28		44	
Percentage of population										
White	78		78		67		55		89	
Nonwhite	22		22		33		45		16	
Percentage of population over 65	7.8		8.6		6.6		7.0		7.1	
Median age	26.9		30.9		26.7		24.6		27.3	
Median years of schooling (for those over 25 years)	8.3		9.6		7.6		8.1		8.4	
Percentage of population in same House as in 1949	75		71		80		78		77	

Source: U.S. Department of Commerce, U.S. *Census of Population, 1950*, Vol. 1, and *Statistical Abstract of the United States*, 1959, p. 10.

EXHIBIT 4

Estimated Changes in Population Components (Cumulative, from 1950–57)

	Arkansas	*Florida*	*Louisiana*	*Mississippi*	*Tennessee*
Net increase (Decrease in number of people in thousands)	−130	1,438	382	−13	152
Percentage increase (Decrease based on 1950 figures)	−7	52	14	−1	5
Number of births, (in thousands)	349	606	627	469	619
Number of deaths	114	230	181	146	213
Net total migration	−365	1,062	−64	−336	−255

Source: U.S. Department of Commerce, *Statistical Abstract of the United States*, 1959, p. 11.

EXHIBIT 5

Number of Births and Birth Rate; Number of Deaths and Death Rate, 1958

	Arkansas	*Florida*	*Louisiana*	*Mississippi*	*Tennessee*
Number of births (thousands)	41	108	90	59	84
Crude birth rate	24	24	29	27	24
Number of deaths (thousands)	17	45	29	21	34
Crude death rate	10	10	9	10	10

Source: U.S. Department of Commerce, *Statistical Abstract of the United States*, 1959, pp. 54 and 64.

EXHIBIT 6

Number of Families and Number of Persons per Family, 1950

	Number of Families (Thousands)	*Number of Persons per Family*
Arkansas	477	3.78
Florida	721	3.44
Louisiana	648	3.87
Mississippi	509	4.04
Tennessee	808	3.83

Source: U.S. Department of Commerce, *U.S. Census of Population*, 1959, Vol. IV, part 2c.

EXHIBIT 7

PERSONAL INCOME* 1950 AND 1957

	Amount of Personal Income (Millions of Dollars)			*Per Capita Personal Income (Dollars)*		
	1950	*1957*	*Percentage Increase*	*1950*	*1957*	*Percentage Increase*
Arkansas	$1,539	$2,035	32	$ 805	$1,151	43
Florida	3,632	7,522	107	1,288	1,836	43
Louisiana	2,937	4,804	64	1,089	1,566	44
Mississippi	1,590	2,093	32	729	958	31
Tennessee	3,288	4,791	46	995	1,383	39

Source: U.S. Department of Commerce, *Personal Income by States*, supplement to *Survey of Current Business*, and *Survey of Current Business*, August, 1958.

* Measure of current income received from all sources during the calendar year by the residents of the state.

EXHIBIT 8

WHOLESALE TRADE, 1954

	Arkansas	*Florida*	*Louisiana*	*Mississippi*	*Tennessee*
Number of establishments (thousands)	1,965	5,309	3,634	1,863	3,877
Payroll, entire year (millions of dollars)	$48	$207	$147	$46	$166
Number of paid employees November 15, work week (thousands)	14	65	40	15	47

Source: U.S. Department of Commerce, *County and City Data Book*, 1956, Table 2.

EXHIBIT 9

RETAIL TRADE, 1954

	Arkansas	*Florida*	*Louisiana*	*Mississippi*	*Tennessee*
Number of establishments (thousands)	19	41	27	17	31
Payroll, entire year (billions of dollars)	$1,334	$4,014	$2,339	$1,282	$2,759
Number of paid employees, November 15, work week (thousands)	54	170	108	56	122

Source: U.S. Department of Commerce, *County and City Data Book*, 1956, Table 2.

EXHIBIT 10

Manufacturing, 1954 and 1957

	Arkansas		*Florida*		*Louisiana*		*Mississippi*		*Tennessee*	
	1954	*1957*	*1954*	*1957*	*1954*	*1957*	*1954*	*1957*	*1954*	*1957*
Number of establishments	2,428	...	4,792	...	3,020	...	2,252	...	4,058	...
Number of employees (thousands)	79	86	124	157	146	144	91	101	267	284
Value of payroll (millions of dollars)	$222	$265	$389	$580	$539	$611	$241	$303	$883	$1,068
Value added by manufacture (millions of dollars)	$457	$640	$798	$1,213	$1,182	$1,492	$468	$581	$1,679	$2,065
Expenditures for new plant and equipment (millions of dollars)	$43	$85	$105	$182	$174	$300	$37	$49	$156	$219

Source: U.S. Department of Commerce, *U.S. Census of Manufactures:* 1954, Vol. III, and Department of Commerce, *Annual Survey of Manufactures*, 1957, Part I.

EXHIBIT 11

NONAGRICULTURAL EMPLOYMENT, 1950 AND 1958

	Arkansas		*Florida*		*Louisiana*		*Mississippi*		*Tennessee*	
	1950	*1958*	*1950*	*1958*	*1950*	*1958*	*1950*	*1958*	*1950*	*1958*
Total number of employees (thousands)	295	333	693	1151	621	766	306	368	740	839
Percent of employees engaged in										
Mining	2	2	1	1	4	5	1	1	2	1
Contract construction	6	5	10	10	7	8	6	4	6	5
Manufacturing	26	26	14	14	22	18	28	30	33	34
Transportation and public utilities	10	8	10	8	12	11	8	6	8	6
Wholsesale and retail trade	24	24	30	30	24	24	24	24	22	23
Finance, insurance, and real estate	3	3	4	6	3	4	3	3	3	4
Service and miscellaneous	12	12	15	16	11	12	10	11	10	11
Government	18	20	17	16	16	17	21	21	15	16

Source: U.S. Department of Commerce, *Statistical Abstract of the United States*, 1959, pp. 214–15.

EXHIBIT 12

INDUSTRIAL AND COMMERCIAL BUSINESS FAILURES, 1958

	Total Number of Concerns in Business	*Number of Failures*	*Failures as Percentage of Concerns in Business*	*Current Liabilities in Thousands of Dollars*
Arkansas	27,343	55	0.20	$ 1,970
Florida	75,448	517	0.69	26,017
Louisiana	44,500	222	0.50	8,683
Mississippi	25,878	88	0.34	3,483
Tennessee	43,934	157	0.36	6,225

Source: U.S. Department of Commerce, *Statistical Abstract of the United States*, 1959, p. 503.

EXHIBIT 13

Life Insurance in Force, 1951 and 1958

	Arkansas		*Florida*		*Louisiana*		*Mississippi*		*Tennessee*	
	1951	*1958*	*1951*	*1958*	*1951*	*1958*	*1951*	*1958*	*1951*	*1958*
Total number of policies (thousands)	1,287	1,455	5,011	8,025	3,452	6,264	1,365	1.812	4,553	5,914
Total value of insurance (millions of dollars)	$1,222	$2,467	$3,785	$10,838	$2,999	$7,043	$1,215	$2,660	$3,711	$7,580
Value per capita (estimated in dollars)	$639	$1,397	$1,275	$2,440	$1,087	$2,265	$553	$1,217	$1,106	$2,185
Total number of ordinary policies (thousands)	397	434	1,119	1,728	793	818	317	399	866	1,058
Total value of insurance (millions of dollars)	$819	$1,556	$2,360	$6,384	$1,625	$3,445	$827	$1,529	$1,995	$3,716
Value per capita (estimated in dollars)	$418	$881	$795	$1,437	$589	$1,108	$376	$699	$594	$1,071
Total number of group policies (thousands)	141	159	439	594	610	505	207	191	514	630
Total value of insurance (millions of dollars)	$209	$534	$520	$2,077	$768	$1,915	$229	$633	$872	$2,202
Value per capita (estimated in dollars)	$109	$302	$175	$468	$278	$616	$104	$290	$260	$664
Total number of industrial policies (thousands)	749	676	3,453	4,483	2,049	3,840	841	847	3,173	3,371
Value of insurance (millions of dollars)	$194	$238	$905	$1,612	$606	$1,164	$159	$243	$844	$1,150
Value per capita (estimated in dollars)	$101	$135	$305	$363	$220	$374	$72	$111	$251	$332

Source: U.S. Department of Commerce, *Statistical Abstract of the United States*, 1959, p. 473; and *Life Insurance Fact Book*, 1952, p. 10.

Barcelona Insurance Company (C)[*]

The executives of the Barcelona Insurance Company (see Barcelona Insurance Company [A]) made the decision to enter the state of Florida first.

The next decision was where to locate in the state. Should the first district be opened in Pensacola which would be geographically close and would give a continuous flow of operations in case the company did open in Mississippi and Alabama? Would it be best to go to Jacksonville where many of the offices of the Florida and national companies were located and which was fast becoming the insurance capital of the South? It is also located on the important North-South highways as well as the railroads and airlines. Should Miami be chosen because of the large number of inhabitants, the wealth of the population, and the possibility of working from the extreme part of the area back toward the home office? Should Orlando be chosen because of its central location and its proximity to the rapidly expanding missile program at Cape Canaveral, and the opportunity for expanding in all directions in the state? This area would also be located on the main highways and would be located in a relatively southern area of the state. Should the Tampa–St. Petersburg area, with its rapidly developing industrial operations, be selected? To be sure, it has a preponderance of older people because of the large number of retired persons who live in the St. Petersburg and Clearwater areas.

If you had to decide upon the location, which of these cities would you select as the state office for the company? Some of the factors that need to be considered are: favorable transportation connections to the home office; a rapidly developing industrial area, because the company primarily sells the industrial type of policy, although it plans to expand into other types in Florida; the location within the state; and the area's future possibilities for growth.

Second, how would you start the operations in the new state? Would you open up only one district and have it coincide with the state office, or would you set up several districts simultaneously in more than one area? If operations prove successful, how would you go about expanding? Would you create continuous districts, or would you locate the districts in separated strategic locations around the state? How would you tackle the problem of sales promotion and advertising in order to get the new company started? Would you use radio, television, newspapers, or other means of advertising the new company? Finally, how much money would you plan to invest each year in addition to the net balance of the income over the expenses of the state operations?

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[*] Prepared by Leon C. Megginson, Louisiana State University.

Barcelona Insurance Company (D)[*]

The executives of the Barcelona Insurance Company (see Barcelona Insurance Company [A]) made the decision to expand district by district in a radial pattern out of the Tampa–St. Petersburg area and to invest $50,000 per year in addition to the net income in the state for expansion and development.

Because of the transient nature of the population in Florida, the problem of obtaining clerical and sales personnel was a relatively minor problem. A large number of people "just left their jobs in Detroit, Chicago, and other northern cities to come to the favorable climate." They were willing and anxious to go to work for the company in this new operation. Also, the people were not inclined to be provincial and did not resent or show any prejudice against the outside company coming in.

One final decision had to be made by the company: that is, whether to select a manager to be responsible for all of the operations in the state, or not. If someone were to be appointed, who should it be?

The president had carefully considered all of the possibilities. First, he had reviewed the records of the managers of the 12 districts and the conclusion is that although some of them had the potential for a state manager, at the time, with their training, experience, and background, none of them had the necessary requisites to be a tip-top field producer and at the same time a good state manager. Some of them would make a good field producer and some would make a good state manager but the right combination of the two was not found in the district manager's rank. It should be emphasized, that if the company had gone into Arkansas, or Mississippi there would not have been a necessity for a state manager, as they could have operated out of the district offices in the home state. Second, he reviewed the record of the officers in the home office.[1] A third possibility was explored. Several years earlier, eight years to be exact, Dave Jones had worked for the company as an agent, and later as a district manager. He had been a successful agent with the company and had also been a successful district manager, after he had built a pioneer debit and district on his own. He was a veteran of World War II, having served as a pilot in the same squadron as the president. After being called back into the Korean conflict, he returned to his native state because of illness in his family. Another consideration in his leaving the company was his desire to be trained and to become competent in other fields of insurance in addition to the industrial area, for instance, in the ordinary life field. At the time of his leaving, it was discussed whether to give him a leave of absence or to terminate his services, with the decision being made to terminate him. Periodic contact had been continued over the intervening eight years with the president visiting in his home and vice versa.

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[*] Prepared by Leon C. Megginson, Louisiana State University.

[1] See: Barcelona Insurance Company (A).

At the time of the decision he was 36 years of age, married, with two children. He had three years of college education but had not received his degree. At that time, he was employed as the manager of a 46-man district of a large national company.

If he were hired as manager, it would be the first time the company had ever brought in an outsider as a manager. Also, the young man is very meticulous and concerned with details in his activities.

The job of the state manager in Florida required a great capacity for potential growth and development. The business was going to be diversified with all phases of life insurance being written by the company. It would require a "tip-top producer" as well as someone who could get along well with people because during the first few years of operations the manager would have to devote the majority of his time to field work and the balance of his time managing the operations of the state office. It would require a lot of traveling and personal contact.

If you were called upon to advise the president as to the man to select as the state manager, whom would you recommend and why?

*First Federal Savings and Loan Association**

At the opening of the first regular bi-weekly meeting in June, 1961, of the operating committee of the First Federal Savings and Loan Association of Jackson, Mr. Bert Scott, chairman, remarked:

"A Washington news release this morning indicates that we may be faced with an executive order requiring savings and loan associations to reduce dividend rates. The amount of the proposed reduction is not indicated, but some of the administration advisors seem to have the idea that this may be one step in accomplishing President Kennedy's objective of lowering interest rates. If an executive order merely fixes a maximum of four per cent for all associations, this, of course, would force some of our competitors, especially in western states, significantly to reduce their dividends below currently advertised rates. However, if each association were to be required to reduce its dividend by a uniform amount, the order, if issued, could have drastic effects.

"In view of the administration's announced plan of bringing about a reduction in interest rates, as well as its goal of an expanded home construction program throughout the country, I think this is a particularly desirable time for us to re-examine our policies and review our plans for future operations. Since World War II, First Federal's assets have doubled just about each seven-year period. We now have assets above $90 million, and indications are that our accounts will pass $100 million within the year."

Another member of the committee, Mr. Bill Huddleston, commented, "There is no question but that we will continue to grow, but I do not believe we can plan on doubling our assets each six to eight years. This would mean that within the next fifteen years we would pass the $400 million mark. Jackson is still a small city, with a population of only a little more than 144,000 persons, while the First Federal is already the fourth largest association in the Little Rock District.[1] Moreover, the American Bankers Association, basing its action on hearings currently in progress in Washington, is attempting to bring strong political pressure to restrict our operations. I think we should gear our planning to our estimates of the future growth of Jackson and its immediate surroundings, and consolidate our operations."

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* Prepared by William T. Hicks, University of Mississippi.

[1] The Federal Home Loan Bank of Little Rock supervises operations in Arkansas, Louisiana, Mississippi, New Mexico, and Texas. The three larger associations referred to are:

a) Dallas Federal Savings and Loan Association, with assets of $147 million.
b) Gibraltar Savings Association of Houston, $115 million.
c) San Antonio Savings Association, $127 million.

A total of 421 associations, insured by the Federal Savings and Loan Insurance Corporation, operated in the five states in 1960.

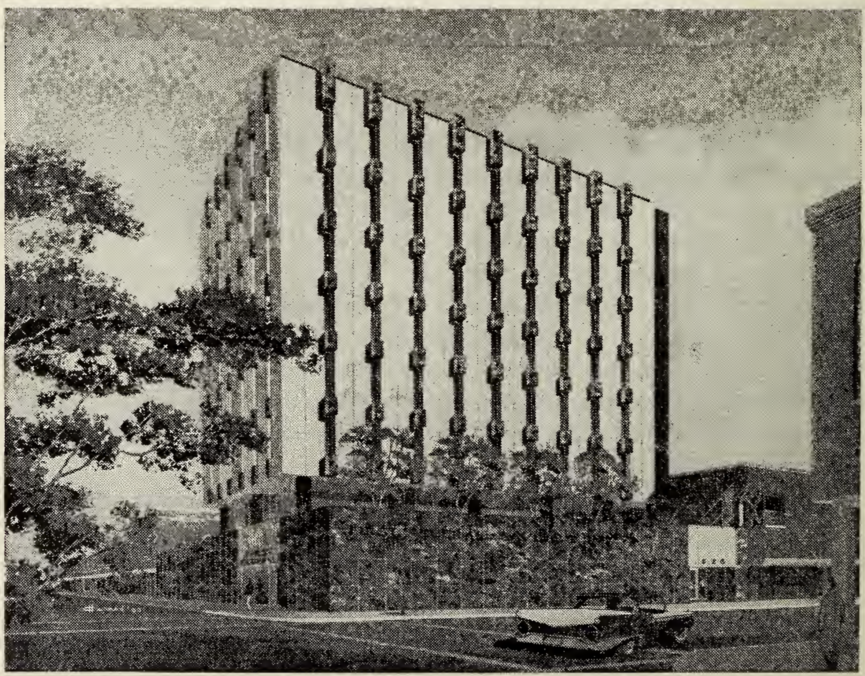
"I think your views are well-taken, Bill," Mr. Charlie Scott, the Association's chief executive officer, observed, "but I feel we should also bear in mind that the First Federal of Jackson has always taken an optimistic view of the future. Many indications now are that the country will experience one of its greatest economic booms during the 1960's, and First Federal should be prepared to serve Jackson and its surrounding areas not only as a savings institution, but also as a leader in the economic growth of this section of the State. Jackson's industrial development is really just beginning. More and more new homes must be constructed for a growing population with steadily rising personal incomes. We also should re-examine our program to meet the city's needs for mortgage loans on commercial and business property, as authorized under Section 5 of the Federal Home Loan Bank Act.

"In fact," Mr. Scott continued, "I am so confident that both Jackson and the First Federal will continue to grow rapidly that I think we should design our new building to meet the needs of a $500 million institution."

History of the Association. The predecessor of the present organization, The Southern Building and Loan Association, was started in Jackson

EXHIBIT 1

Architect's Conception of First Federal Building



in 1922 as a mutual association with a Mississippi state charter. Frank T. and Charlie Scott, partners in law, were the organizers, and they managed the Association in their law office for about one year. They, Thad B. Lampton, the first president, and nine others composed the first board of directors. There was no remuneration to anyone in the beginning, but in about 12 months, Dr. M. W. Swartz was employed as secretary and manager, at an initial salary of $25.00 per month. Soon thereafter the members of the Board were paid $5.00 per month. Dr. Swartz came to Mississippi from Virginia as professor of Greek at Millsaps College in 1905. He later served as president of the Woman's College of Alabama.

Mr. Thad B. Lampton, the first president, was also president of the Capital National Bank of Jackson.[2] He and the other directors were far-sighted businessmen who wanted this institution to fill a need in Jackson at that time.

When the stock market crash occurred in 1929, the Southern Building and Loan Association had grown to an institution of over $2½ million, the second largest in the state, and was considered a sizable association for that period. The years from 1929 to 1934 were ones of stress and liquidation for a great many financial institutions. In 1934 the Southern Building and Loan Association was converted to a federal charter, with Thad B. Lampton, chairman of the board; W. B. McCarty, president; and Charlie Scott, secretary, executive vice-president and manager. Other members of First Federal's board were C. C. Smith, V. T. McCleland, Mrs. Jennie H. Peeples, and Dan Bufkin. For one reason or another, several members of the board of directors of the state-chartered Association did not go on the board of First Federal.

Four of the original directors of the Southern Building and Loan Association are still on the board of First Federal in 1961. They are W. B. McCarty, Sr., C. C. Smith, V. T. McCleland, and Charlie Scott. First Federal's success, to a considerable extent, is attributed to the able leadership and excellent business reputation of these four individuals. Mr. W. B. McCarty, Sr., for example, was a founding partner of the McCarty-Holman Grocery Company and of the Jitney Jungle chain of grocery stores. He also is a director of Deposit Guaranty Bank and Trust Company,[3] The Standard Life Insurance Company, the Citizens' Publishing Company (*State Times*, a daily newspaper in Jackson), and owns a radio station as well as other business enterprises in Jackson. Mr. C. C. Smith, another director throughout the life of the association, has had wide experience as a land broker, and owns one of the major office buildings in Jackson. The third director with continuous service is Mr. V. T. McCleland, who has the distinction of having attended every board meeting.

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[2] Now the First National Bank.

[3] The largest bank in Mississippi in 1961.

For many years he operated one of the principal hardware stores in Jackson, and, since retiring from that operation, has had successful experience in a number of business ventures.

Continuity of management throughout the history of both associations has been provided by Mr. Charlie Scott. Charlie is a native of Kemper County, Mississippi, a graduate of Baylor University, and since 1920 has been a partner of the law firm of Scott and Scott (now Scott, Barbour, and Scott). After serving as executive vice-president and manager of First Federal from 1934 to 1947, he was elected president, at which time Mr. W. B. McCarty, at his request, became chairman of the board.

In commenting on the experiences of savings and loan associations during the business depression period of 1929–1933, Mr. Charlie Scott remarked: "The associations in Mississippi did a most remarkable job in liquidating. While other financial institutions all over the country were taking heavy losses, including building and loan associations in most states, those in Mississippi completed their liquidation without any loss whatsoever, so far as I am able to find, to a single depositor."

The minutes of the meetings of the board of directors reflected the thinking of many of the members as to the heavy restrictions which might be placed on operations by the New Deal and a federal charter. While many members were fearful of the potential restrictions, Mr. Charlie Scott emphasized at board meetings that a new opportunity had developed "for the association to cooperate with the federal government and that plans should be made accordingly. Discussion should be on what the association can do, not on what it cannot or should not do." Active cooperation with the agencies of the New Deal, it was finally decided, would provide the best opportunity for future growth.

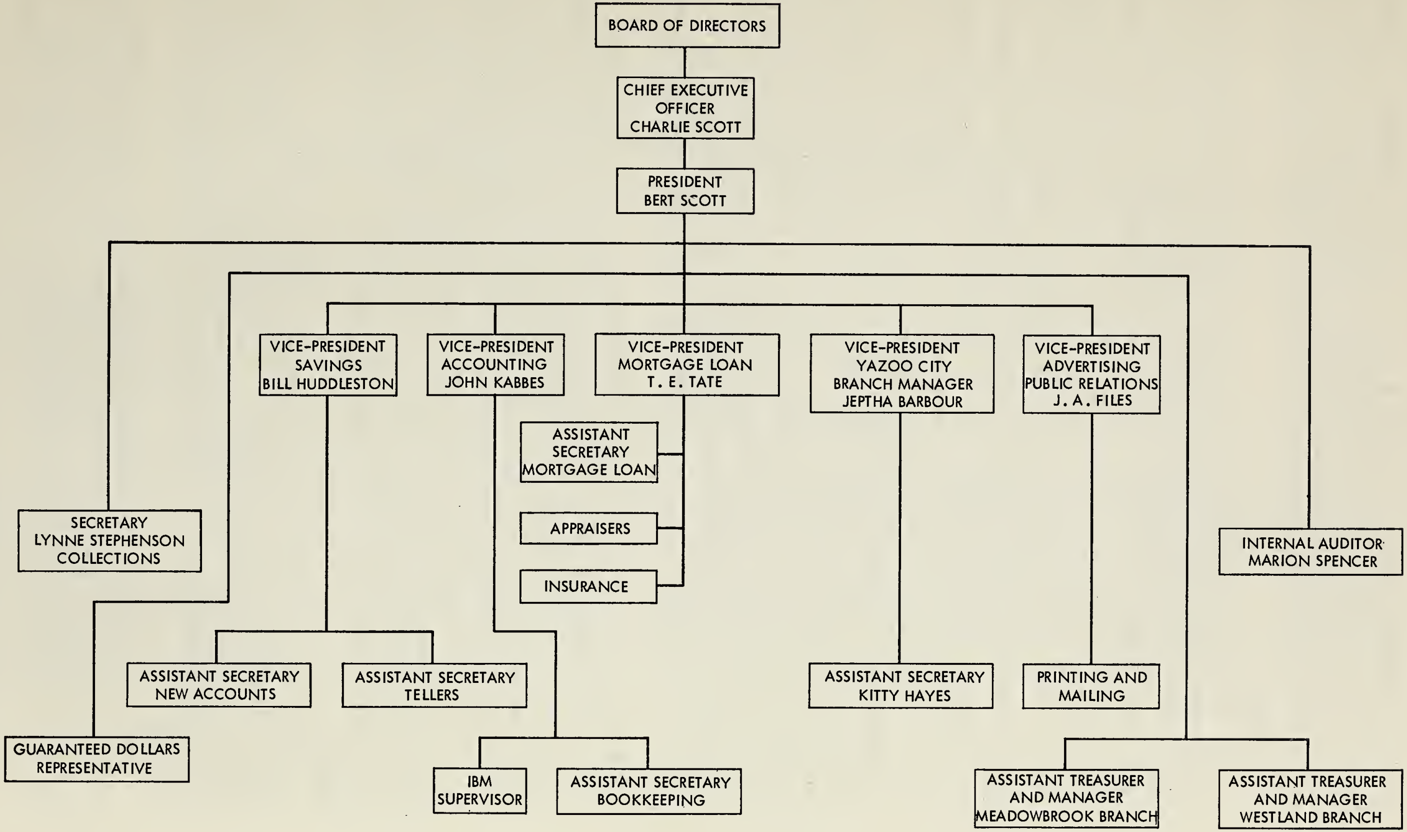
In contrast to the decision of the board of directors of the Southern Building and Loan Association to continue operations under a federal charter, the Jackson Building and Loan Association announced that it had decided not to carry on in the face of potential government interference and competition. Assets of the latter company, exceeding $7.5 million in 1929, comprised about half of the assets of savings and loan associations in Mississippi at that time.

By the end of 1934, First Federal had its federal charter and total assets of $326,000. By the end of World War II, assets had grown to $8 million, and to $26 million in 1953 when the Republican administration came into power. Definite progress resulted each year thereafter, and by early 1961 total assets had passed the $90 million mark.

Organization in 1961. The board of directors is composed of ten men. In addition to the four who have served continuously since the organization was established in 1922, six other leading Jackson businessmen are members. Three of these, Mr. H. O. Smith, Mr. McCleland Taylor, and Mr. Breck Cabell, are also directors of the First National Bank of

EXHIBIT 2

Organization Chart


BOARD OF DIRECTORS
CHIEF EXECUTIVE OFFICER CHARLIE SCOTT
PRESIDENT BERT SCOTT
SECRETARY LYNNE STEPHENSON COLLECTIONS
GUARANTEED DOLLARS REPRESENTATIVE
VICE-PRESIDENT SAVINGS BILL HUDDLESTON
ASSISTANT SECRETARY NEW ACCOUNTS
ASSISTANT SECRETARY TELLERS
VICE-PRESIDENT ACCOUNTING JOHN KABBES
IBM SUPERVISOR
ASSISTANT SECRETARY BOOKKEEPING
VICE-PRESIDENT MORTGAGE LOAN T. E. TATE
ASSISTANT SECRETARY MORTGAGE LOAN
APPRAISERS
INSURANCE
VICE-PRESIDENT YAZOO CITY BRANCH MANAGER JEPTHA BARBOUR
ASSISTANT SECRETARY KITTY HAYES
VICE-PRESIDENT ADVERTISING PUBLIC RELATIONS J. A. FILES
PRINTING AND MAILING
ASSISTANT TREASURER AND MANAGER MEADOWBROOK BRANCH
ASSISTANT TREASURER AND MANAGER WESTLAND BRANCH
INTERNAL AUDITOR MARION SPENCER

Jackson.[4] Another, Mr. W. B. McCarty, Jr., is also a director of the Deposit Guaranty Bank and Trust Company. Of the other two directors, Mr. Tom B. Scott is a member of the law firm of Scott, Barbour, and Scott, attorneys for the Association, and Mr. Bert Scott is president of the Association.

The directors are elected for three-year terms by the members of the Association, with approximately one-third selected at each annual meeting. Both holders of savings accounts and borrowers are members. One vote is authorized for each $100, or fraction thereof, in each member's savings account up to a maximum of 50 votes. Each borrowing member has one vote, which may be in addition to votes as a holder of a savings account. The tie-in of the directors with the two leading banks in Mississippi, mentioned above, appears to be more accidental than planned. In fact, with the exception of Mr. W. B. McCarty, Sr., all were directors of the First Federal before they were made directors of the banks. All officers of the Association are elected by the board of directors.

Operations. General operations of the Association are under Mr. Charlie Scott, chief executive officer. Day-to-day operations are under the president, Mr. Bert Scott, who is assisted by five vice presidents. Bert is a native of Jackson and attended the Jackson Law School and the University of Mississippi. Although trained as an attorney, he started with the Association in its mortgage loan department as an appraiser, later was elected vice-president, then executive vice-president, and president in 1959.

The vice-president in charge of the Mortgage Loan department, Mr. T. E. Tate, is a graduate of Mississippi State University with a major in education and social studies. He began his career as a teacher of social studies and shop operations at Forrest Hill High School near Jackson, but joined the First Federal as an appraiser in the Mortgage Loan department in 1951. He is a graduate of the American Institute of Real Estate Appraisers, a distinction held by only two other appraisers in the State of Mississippi. His unusual ability to evaluate the merits of loan applications is recognized as a major factor in the success of the Association in the past decade.

The Savings department is supervised by Bill Huddleston, a native of Utica, Mississippi, and a graduate of Mississippi State University with a major in accounting. Prior to joining the First Federal, he was comptroller for the Mississippi Baptist Convention Board and the MRS Manufacturing Company.

The vice-president in charge of public relations and advertising is James A. Files, a native of Louisiana with a bachelor's degree from Louisiana Tech and a master's degree from the University of Utah. Prior to joining the staff of First Federal, he was a newspaper editor, su-

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[4] The second largest bank in Mississippi.

EXHIBIT 3

First Federal Savings and Loan Association of Jackson
Financial Statements for Years 1940, 1945, 1950, 1955, 1960, and June 30, 1961

Assets	*December 31, 1940*	*December 31, 1945*	*December 31, 1950*	*December 31, 1955*	*December 31, 1960*	*June 30, 1961*
Cash	$ 63,837	$ 183,070	$ 794,330	$ 1,329,849	$ 1,414,534	$ 998,472
U.S. bonds	...	699,850	1,250,000	3,463,468	7,194,620	7,733,835
First mortgage loans	2,273,952	4,858,875	15,281,198	47,594,093	75,714,058	78,747,953
Loans on savings accounts	15,198	27,936	194,229	901,005	362,599	424,165
Stock in F.H.L.B.	18,800	38,000	130,000	725,000	1,298,700	1,398,300
Land, buildings, and equipment	100	65,000	90,000	381,639	781,525	1,101,150
Other assets	203	...	...	17,942	150,087	169,726
Total Assets	$2,372,090	$5,872,731	$17,739,757	$54,412,996	$86,916,123	$90,573,601
Liabilities						
Savings accounts	$2,029,753	$5,406,767	$15,388,008	$47,799,542	$76,131,436	$81,423,651
Advanced from F.H.L.B.	170,000	...	1,000,000	3,000,000	4,000,000	1,000,000
Loans in process	3,210	11,726	37,063	39,535	196,639	706,779
Other liabilities	2,973	1,279	15,314	250,646	418,309	1,041,309
Deferred income	...	...	...	1,474	4,908	5,887
General reserves and surplus	166,154	452,959	1,299,472	3,321,799	6,164,831	6,395,975
Total Liabilities	$2,372,090	$5,872,731	$17,739,757	$54,412,996	$86,916,123	$90,573,601

Source: Tabulated by Mr Kabbes

EXHIBIT 4

First Federal Savings and Loan Association of Jackson
Source and Distribution of Gross Income

Source of Income	*First Federal** *(Percent)*	*All Member Associations†* *(Percent)*
Interest on mortgage loans	87.2	82.7
Investments and bank deposit interest	5.3	5.0
Fees, services, and other	7.5	12.3
Total	100.0	100.0
Distribution of Income		
Compensation	8.3	10.2
Other operating expenses	15.2	15.0
Dividends paid	66.5	56.9
Transferred to reserves	10.0	17.9
Total	100.0	100.0

* For 1960, based on company records.

† For 1959, latest available data in 1961 Chart Book of Federal Home Loan Bank Board on operations of federally insured associations.

pervisor of public relations for Mississippi Products, Inc., and was connected with the advertising-public relations department of Braniff International Airways. He has also been a faculty member of Louisiana Tech and of The University of Mississippi-Millsaps College Center.

Mr. John T. Kabbes serves as treasurer and vice-president in charge of the Accounting department. He is a native of Jackson, and attended St. Louis University and the Jackson School of Law. In addition to being a member of the Mississippi Bar, he is a Certified Public Accountant. His experience prior to joining First Federal included employment by the Mississippi State Bank Comptroller and the private practice of public accounting. He started work with First Federal as comptroller in 1955, and was appointed treasurer and vice-president in 1956.

The above four vice-presidents meet regularly with the president as an informal operating committee to discuss problems and procedures.[5] Such a committee, several members emphasized, is especially worth while in evaluating new ideas.

Savings Program. Activities of all savings and loan associations center around two basic economic functions—the encouragement of citizens to save and the provision of facilities for home-financing. States have for many years provided legislation authorizing the issuing of charters to building and loan associations organized on a mutual basis, but provision for federal charters was first made with the Home Owners' Loan Act of 1933.[6] In that year total assets of all American associations were $7 billion.

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[5] The fifth vice-president, Mr. Jeptha Barbour, is in charge of the Yazoo City Branch of First Federal and only occasionally meets with the operating committee.

[6] A summary of the provisions of the Home Owners' Loan Act, the Federal Home Loan Bank Act, and Title IV of the National Housing Act is given in Appendix A.

EXHIBIT 5

Total Assets of First Federal
and
All Federally Insured Savings and Loan Associations
(Specified Years)

December 31	*First Federal (Millions of Dollars)*	*All Insured Associations (Billions of Dollars)*
1934	0.33	0.15
1940	2.37	2.93
1945	5.87	6.12
1950	17.74	13.69
1955	54.41	34.20
1956	60.82	39.34
1957	64.19	44.46
1958	70.70	51.31
1959	80.71	59.55
1960	86.92	67.43
1961 (June 30)	90.57	...

Source: Company records and Federal Home Loan Bank Board reports.

In spite of the provision for insurance through the Federal Savings and Loan Insurance Corporation, established in 1934, the development of the savings and loan business as a major segment of the American economy did not begin until after World War II. Assets of all associations in 1945 were only $8.7 billion, but growth thereafter was rapid and assets passed $71 billion in 1960 (includes $4 billion noninsured).

The First Federal of Jackson, in developing its program to encourage thrift by means of savings accounts, has followed a pattern typical of most associations throughout the country. Emphasis is placed on three types of accounts: (1) passbook savings accounts, (2) guaranteed dollar

EXHIBIT 6

Resources of Savings and Loan Associations
Jackson Metropolitan Area

Name	*December 31, 1959*	*December 31, 1960*
American National Savings & Loan Assn.	$ 500.00	$ 21,064.47
Bankers Trust Savings & Loan Assn.	215,320.03	287,208.83
Church Building & Loan Association	517,668.96	734,534.33
Clinton Savings & Loan Association*	368,876.61	483,812.70
Confederate States Savings & Loan Assn.	1,442,368.00	2,524,282.89
Guardian Trust Savings & Loan Assn.	...	21,980.37
Home Savings & Loan Assn. (*Brandon*)†	118,432.31	151,419.93
Homestead Savings & Loan Assn.	2,677,484.52	3,479,863.66
Magnolia Savings & Loan Assn.	7,225,262.41	9,725,126.44
South Central Savings & Loan Assn.	...	214,699.31
State Mutual Savings & Loan Assn.	196,151.87	338,940.52
Subtotal	$12,762,064.71	$ 17,982,933.45
First Federal	80,708,693.90	86,923,949.34
Total	$93,470,758.61	$104,906,882.79

* 10 miles west of Jackson.
† 12 miles east of Jackson.
Source: Calculated by Mr. Files from best available information.

accounts, and (3) certificate accounts. The first two are designed for persons wishing to "save," while the third is for persons desiring to "invest" in this type of firm with the principal objective of obtaining a regular return.

Of the 32,000 accounts held by First Federal, over 90 per cent are passbook accounts, with an average balance of $2,300. Such accounts may be opened in any amount, additions to accounts[7] may be made at any time in any amount, and earnings are credited to the account semiannually. Withdrawals similarly may be made at any time.

The second type of account, which has been actively promoted by First Federal only since 1957, combines a regular monthly savings account with decreasing term life insurance to give the results of the usual endowment policy offered by insurance companies. For example, a man thirty years of age, by saving $17.46 with First Federal each month, will have an account worth $5,630.32 in twenty years; or by saving $19.07 monthly for thirty years, he will have $11,893.00. As explained by Mr. Huddleston, "Guaranteed dollars plans are available for periods of 10, 15, 20 years, or longer. These plans are quite flexible, however, and can be designed to fit any particular situation, regardless of amount or length of time desired. No physical examination is required for persons under 45 desiring less than $13,600 insurance. Withdrawals may be made at any time during the lifetime of the plan, providing an extra reserve fund for emergencies if necessary." Only about two per cent of the members use the guaranteed dollar plan, as most seem to prefer the flexibility of the regular passbook accounts.

The third type is the certificate or investment account providing for credits in multiples of $100, with dividend checks mailed semiannually. About seven per cent of First Federal accounts are of this type. The average size of such accounts, however, is considerably higher than the other types.

Several specialized types of ownership are advertised, particularly joint accounts, organization accounts, and trustee accounts. Mr. Huddleston feels that there is perhaps an opportunity for the Association to develop greater interest in the trustee type of ownership. Trustee accounts, for example, permit funds upon death of the grantor to pass automatically and irrevocably to named beneficiary without the expense of legal procedure.

No analysis of customer preferences and attitudes towards savings practices has been made by First Federal to determine the potentials of the specialized programs. A survey of members was made by Mr. Huddleston in 1959 primarily for the purpose of locating its proposed new headquarters building. Interesting points were that slightly over half of all additions to accounts were made by women, that only 29 per cent of the additions to accounts were made by mail, that there was no particular concentration by age group, although 23 per cent of account owners were over 60, and that three-fourths of the customers made a trip by private car, primarily to visit First Federal,[8] each time an addition was made.

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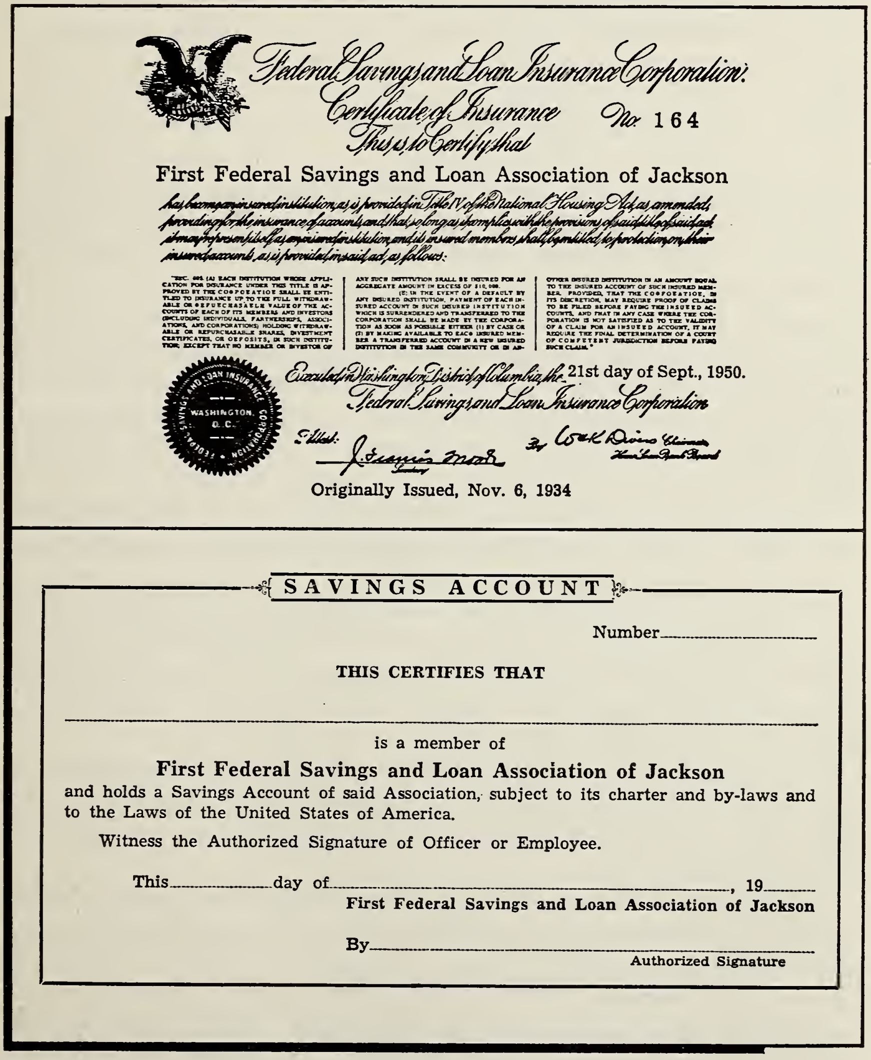
[7] Accounts with savings and loan associations often are popularly called "deposits," but legally an account represents a membership. Savings and loan associations are a mutual type of corporation, owned and controlled by the members. Members include persons who save with the association and persons who borrow.

In the operation of the savings program, a key feature is the passbook (see Exhibit 7). To each passbook an account number is assigned, which

EXHIBIT 7

DESIGN OF FIRST FEDERAL PASSBOOK



Federal Savings and Loan Insurance Corporation:
Certificate of Insurance *No.* 164
This is to Certify that

First Federal Savings and Loan Association of Jackson

has become an insured institution, as is provided in Title IV of the National Housing Act, as amended, providing for the insurance of accounts, and that, so long as it complies with the provisions of said title of said act, it may represent itself as an insured institution, and its insured members shall be entitled to protection on their insured accounts, as is provided in said act, as follows:

"SEC. 405. (A) EACH INSTITUTION WHOSE APPLICATION FOR INSURANCE UNDER THIS TITLE IS APPROVED BY THE CORPORATION SHALL BE ENTITLED TO INSURANCE UP TO THE FULL WITHDRAWABLE OR REPURCHASABLE VALUE OF THE ACCOUNTS OF EACH OF ITS MEMBERS AND INVESTORS (INCLUDING INDIVIDUALS, PARTNERSHIPS, ASSOCIATIONS, AND CORPORATIONS) HOLDING WITHDRAWABLE OR REPURCHASABLE SHARES, INVESTMENT CERTIFICATES, OR DEPOSITS, IN SUCH INSTITUTION; EXCEPT THAT NO MEMBER OR INVESTOR OF ANY SUCH INSTITUTION SHALL BE INSURED FOR AN AGGREGATE AMOUNT IN EXCESS OF $10,000.

(B) IN THE EVENT OF A DEFAULT BY ANY INSURED INSTITUTION, PAYMENT OF EACH INSURED ACCOUNT IN SUCH INSURED INSTITUTION WHICH IS SURRENDERED AND TRANSFERRED TO THE CORPORATION SHALL BE MADE BY THE CORPORATION AS SOON AS POSSIBLE EITHER (1) BY CASH OR (2) BY MAKING AVAILABLE TO EACH INSURED MEMBER A TRANSFERRED ACCOUNT IN A NEW INSURED INSTITUTION IN THE SAME COMMUNITY OR IN ANOTHER INSURED INSTITUTION IN AN AMOUNT EQUAL TO THE INSURED ACCOUNT OF SUCH INSURED MEMBER. PROVIDED, THAT THE CORPORATION, IN ITS DISCRETION, MAY REQUIRE PROOF OF CLAIMS TO BE FILED BEFORE PAYING THE INSURED ACCOUNTS, AND THAT IN ANY CASE WHERE THE CORPORATION IS NOT SATISFIED AS TO THE VALIDITY OF A CLAIM FOR AN INSURED ACCOUNT, IT MAY REQUIRE THE FINAL DETERMINATION OF A COURT OF COMPETENT JURISDICTION BEFORE PAYING SUCH CLAIM."

Executed in Washington, District of Columbia, the 21st day of Sept., 1950.
Federal Savings and Loan Insurance Corporation

Attest: J. Francis Moore, *Secretary*   *By* W. K. Divers, *Chairman, Home Loan Bank Board*

Originally Issued, Nov. 6, 1934

SAVINGS ACCOUNT

Number..............................

THIS CERTIFIES THAT

....

is a member of

First Federal Savings and Loan Association of Jackson

and holds a Savings Account of said Association, subject to its charter and by-laws and to the Laws of the United States of America.

Witness the Authorized Signature of Officer or Employee.

This..................day of.., 19..........

First Federal Savings and Loan Association of Jackson

By..
Authorized Signature

Note: Enlarged by 12 percent.

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[8] Appendix B shows questionnaire used for the survey.

serves as a control feature in record-keeping. Although it is not mandatory that account holders present the passbook for each transaction, First Federal strongly encourages the practice as an additional aid in smoothness of operations. Even when transactions are by mail, the passbook customarily is transmitted for both account additions as well as withdrawals. A teller writes in each entry under the appropriate heading—dividend, withdrawal, or deposit—calculates and writes in the balance. A record of each transaction is also made on an appropriate form for internal control. In addition, all transaction slips are microfilmed daily. Reference to old files thus may be made by dates, although this is seldom necessary.

Currently plans are being developed for electronically processing all account transactions with IBM equipment. This has already been established for borrowers, as pointed out below, and it is believed that the installation will facilitate service to savings account owners as well. One operating detail which will be expedited is that of the exchange of information among the branch offices on members who may make withdrawals from more than one office. At present it is customary for First Federal to issue a check, payable to the customer, on a commercial bank, thereby providing additional identification control.

Lending Program. Associations incorporated under a Federal charter are limited to loans on real estate first mortgages and investments in U.S. government bonds. Over 85 per cent of First Federal assets are first mortgages; of the remaining, ten per cent are in cash and U.S. government bonds, and five per cent are in stock of the Federal Home Loan Bank of Little Rock, the home office building, and equipment.

First Federal makes three types of loans: FHA, VA, and conventional. The FHA and VA loans make up slightly over half of its outstanding loans, and the conventional loans make up the balance.

The FHA loan is one which the Federal Housing Administration insures for 100 per cent, thus greatly reducing risk to the lending agency. However, Mr. Tate feels that the attractiveness of such loans to potential lenders is greatly reduced by the fact that, in the event of foreclosure, payment is made in government debentures rather than in cash.

A VA loan is a loan which the Veterans Administration guarantees for 60 per cent of the outstanding loan amount, or $7,500, whichever is the lesser. The VA program is attractive to many lenders because of its cash payoff provisions.

A conventional loan is a loan for which First Federal makes the appraisal, and takes the full responsibility of the risk involved in the event that foreclosure is necessary. After the appraisal is made, the association then contracts with the owner to lend a certain amount of money. Loans on property in first-class neighborhoods, termed "prime loans," may be made for 75 to 80 per cent of the appraised value. Loans on property in less stable neighborhoods (neighborhoods characterized by greater movement of population and uncertainty as to the continued desirability of the area as a residential section) are made for a smaller proportion of the appraised value and carry a higher rate of interest.

All of the above type loans are handled on both proposed and existing construction.[9] In the case of proposed construction, the loan is based on an evaluation of the plans, specifications, and building lot.

The lending program of a savings and loan association is dependent upon the association's skill in making sound appraisals of the real estate on which mortgage loans are made. "No matter how rapidly a savings and loan association may grow, and regardless of its reserves and liquidity, the breadth of services it renders, or the prestige it commands," Mr. Tate stresses, "no association can expect to maintain its place in the community or in the financial field if it makes poor loans. There must be a sound appraisal to make possible a sound lending policy in order for the institution to exist."

First Federal believes that the appraiser has parallel responsibilities: first, the responsibility to the institution to protect it from unsound loans and, second, the moral responsibility to the investing public to neither overestimate nor underestimate the value of properties offered as security.

Regulations of the Federal Home Loan Bank Board provide that 20 per cent of an association's loans may be on first mortgages on commercial real estate. So far, First Federal has limited its loans in this field to about 10 per cent, primarily loans on new shopping centers. Such loans generally are limited to 60 per cent of the appraised value. Mr. Tate, vice-president in charge of the Mortgage Loan department, said some thought had been given to increasing the number of loans of this type, but that present plans were to continue concentration on loans on dwelling units, especially on the one-family type residence. This decision follows the basic philosophy of the savings and loan business, although frequently higher interest rates might be obtained on commercial property.

The average home loan made by First Federal is for $13,000, and in 1961 the average balance per residential loan was $7,500. Two noticeable trends of the past five years have been the increase in the number of shell homes[10] and in the demand for homes costing above $20,000. Loans on shell homes are made only occasionally by First Federal, and then only on ones which have been completely finished, although many of the non-Federally insured savings and loan associations follow a more liberal policy. A question frequently discussed, Mr. Tate mentioned, is whether

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[9] The procedure used by First Federal for handling FHA appraisal requests on existing construction is given in Appendix C.

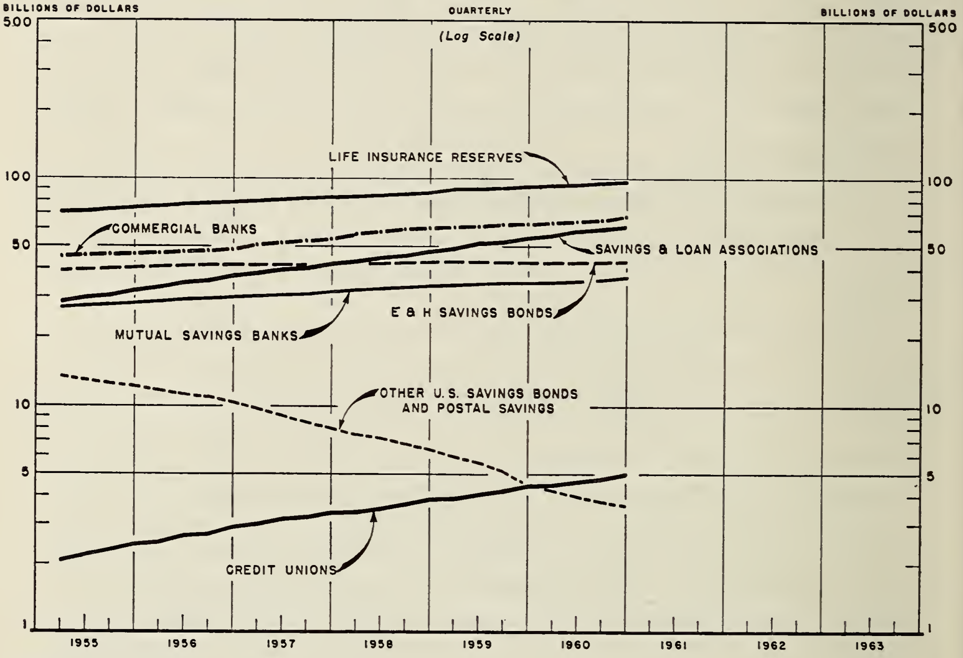
[10] The term "shell homes" usually refers to wooden frame houses, finished on the outside but unfinished on the inside, with only subfloors. They are without plumbing, electrical wiring, or painted walls.

First Federal should continue to concentrate on medium-priced homes, or expand the proportion of its loans on less expensive as well as more expensive homes.

Competition. Active competition both in obtaining savings accounts and in making loans is faced by First Federal. Nationally, of the $18 billion invested during 1960 by individuals, $7.6 billion was placed with savings and loan associations, $4.6 billion in savings accounts with commercial banks, $4.4 billion in life insurance reserves, and the remaining $1.6 billion in mutual savings banks and credit unions. Mr. Huddleston believes the same pattern probably prevails in Jackson, and estimates that the total assets of savings and loan associations on December 31, 1960, were $105 million, and deposits in savings accounts of commercial banks were somewhat above $41 million. Competition for savings therefore is active among the three principal types of financial institutions, as well as among the several firms of each type.

EXHIBIT 8

Investments of Individuals in Savings Accounts, U.S. Savings Bonds and Life Insurance Reserves



OPERATING ANALYSIS DIVISION
FEDERAL HOME LOAN BANK BOARD

In Jackson, as is true in many cities throughout the country, the competition for funds is particularly noticeable in the establishment of branches both by banks and by savings and loan associations. The First

National Bank of Jackson operates six branches in the metropolitan area and the Deposit Guaranty operates eight branches.

In 1961 First Federal established two branches in metropolitan Jackson: Westland in the western part of the city, and Meadowbrook in the northern part of the city. Another branch in Yazoo City, 45 miles northwest of Jackson, was established in 1960. A convenient location appears to be a major influence on customers in selecting a financial institution.

Nine other savings and loan associations operate in Jackson and two in the nearby towns of Brandon and Clinton. All of these are State chartered; however, only one—the Magnolia Savings and Loan Association—is a member of the Federal Home Loan Bank System and, thus, insured by the Federal Savings and Loan Insurance Corporation. Growth of all of the associations was rapid between 1959 and 1960, as shown on Exhibit 6.

In making real estate loans, competition is provided by insurance companies, mortgage bankers, other savings and loan associations, commercial banks, and individuals. In 1961, Mr. Tate estimates, savings and loan associations handled about half of the mortgages on homes in the Jackson area, with First Federal holding between 40 per cent and 45 per cent of the total. A breakdown of the holding of the other institutions is not available, but in 1960 the percentage distribution of home mortgages among lenders nationally was: savings and loan associations, 38 per cent; insurance companies, 18 per cent; commercial banks, 15 per cent; individual and mutual savings banks,[11] 12 per cent each; and all others,[12] 5 per cent.

Interest Rates. Competition among financial firms is also vividly indicated by advertisements on interest or dividends to be paid. The ten non-Federally insured savings and loan associations in the Jackson metropolitan area advertise rates paid to members from ½ per cent to 2 per cent higher than the 4 per cent rate indicated by First Federal and Magnolia. Commercial banks similarly emphasize a 3 per cent rate on time deposits, along with full commercial banking facilities.

Inter-regional competition for savings funds is highly active among savings and loan associations. During the week of July 31, 1961, nine Federally-insured associations had advertisements in the Dallas edition of *The Wall Street Journal,* all emphasizing a dividend rate of 4½ per cent. Among the group was an ad by the nation's largest, California Federal Savings and Loan Association, Los Angeles, with assets of over $666 million. Similarly, in *The New York Times* of Sunday, July 30, 1961, fourteen federally-insured associations had displays emphasizing 4½ per cent returns, gifts, and quarterly dividends.

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[11] Mutual savings banks do not operate in Mississippi.

[12] More complete data on home financing can be obtained from the *Savings and Loan Fact Book,* issued annually by the U.S. Savings and Loan League, 221 North LaSalle, Chicago 1, Illinois.

Operations of a savings and loan association, Mr. Jim Files points out, must be sensitive to changes in interest rates both in obtaining funds and in making loans. As interest rates rise in a particular area, a higher rate of return on loans becomes possible, but at the same time competition for savings accounts is intensified, and higher dividend rates frequently are advertised.

Nonfederally-insured associations[13] find it necessary and profitable to advertise rates higher than those of Federally-insured associations. During 1961 several nonfederally-insured ones advertised rates of 5 per cent on passbook accounts and 5 ½ per cent on savings certificates.

First Federal advertises no specific rate on loans. The prime mortgage rate in the Jackson geographic area during the first part of 1961 varied from 5 ¾ to 7 per cent, depending upon the appraisal (and security) of each loan. In fact, Mr. Files emphasizes that it is a sound business policy for financial institutions to advertise a rate which depositors can expect, but that it is impossible to advertise a rate which will be charged on loans in general. Each conventional loan, whether made by a savings and loan association or by other lending agencies, must be individually appraised and negotiated. On a real estate first mortgage, a prediction must be made of the economic and social outlook of each neighborhood for ten to twenty years or more. Furthermore, variations in the practices of lenders in calculating closing costs and other charges makes it difficult to compare an advertised rate of any one lender with rates of other firms.

Accounting System. Accounting procedures for associations which are members of the Federal Home Loan Bank System must meet established specifications. First Federal's system is designed both to meet such requirements, as well as to provide a guide for day-to-day operations.

Mr. Kabbes, vice-president and treasurer, summarized the income and expense accounts of First Federal by saying that gross income averaged 5.5 per cent of total savings at the end of the year 1960. Operating expenses on the other hand were 1.3 per cent, thereby providing a net return during the year of 4.2 per cent on the year-end total. Since dividends to each savings account owner are paid on the balance as of June 30 and December 31, and since many new accounts and net additions to or withdrawals from old accounts were recorded during the year, the 4 per cent dividend rate paid to customers on eligible accounts actually was only 3.5 per cent of the total year-end accounts. First Federal thus was able to transfer to its reserve account .7 per cent of total savings on hand as of December 31.

Certain reserve account regulations resulted in considerable controversy at tax hearings before the House Ways and Means committee during the first eight months of 1961. One requirement, for instance, is that each association, after twenty years of operation (which of course applies to First Federal), must have a minimum reserve of 5 per cent of all savings accounts. After the twenty years, the firm must place 10 per cent of net earnings before dividends in its reserve until the reserve equals 12 per cent of total savings. The 12 per cent is thus a reserve goal which generally is believed by persons in the savings and loan business to be sufficient to sustain any losses which a particular association conceivably might anticipate. First Federal's reserve as of June 30, 1961, equalled 7.75 per cent of its savings accounts.

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[13] See Appendix A for legal provisions of such associations.

Federal income tax laws, Mr. Kabbes explained, permit savings and loan associations to transfer earnings to reserves without payment of an income tax on such transfers as long as the total reserve does not exceed 12 per cent of savings. Commercial banks, on the other hand, can transfer earnings to reserve without payment of income tax only so long as banks' reserves do not exceed three times the moving average of losses for the past twenty years, or about 2.4 per cent of outstanding loans. A 1961 proposal by the U.S. Treasury Department is to reduce the 12 per cent reserve goal.[14]

Considerable criticism of the Federal Home Loan Bank System's 12 per cent reserve goal for bad debts has been made by the American Bankers Association on the grounds that this reserve is higher than is needed for reasonable protection against financial contingencies. An unfair competitive advantage, it is claimed, is thereby given to the associations by the tax provision exempting such transfers from the income tax. Since assets of most savings and loan associations are growing from year to year, the American Bankers Association maintains that almost every association can transfer all of its earnings after dividends have been paid to the bad debt reserve and still remain under the 12 per cent limit.

In complying with the Federal Savings and Loan Insurance Corporation regulation that each insured association must maintain a cash liquidity position of 7 per cent,[15] First Federal follows a policy of maintaining the percentage at 10 or more. Usually about two-thirds of the firm's liquid assets are in U.S. Government securities. Since deposits in Federal Home Loan Banks yield only 2 per cent interest, versus 3 per cent or more from U.S. bonds, only limited funds are placed with such banks.

A significant liquidity provision for savings and loan associations is the ability to borrow up to 50 per cent of savings from the Federal Home Loan Bank. First Federal normally borrows only about 1 per cent, and in only one year, 1959, did it borrow as much as 7 per cent.

For the past year, as Mr. Kabbes explained, IBM equipment has been used for all mortgage loan accounting. Three types of cards are maintained for each loan: (1) an address card, (2) a statistical card, and (3) a balance card. Information covering the appraised value of each property, purchase price, terms of the loan, payments, escrow balance for taxes and insurance, as well as balance due on principal, is thus imme-

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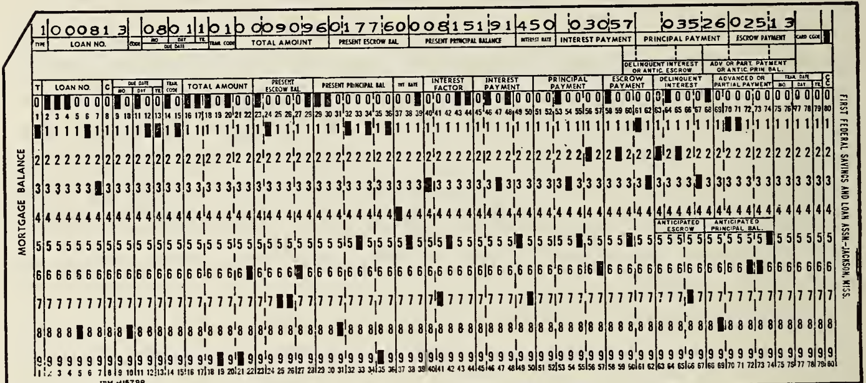
[14] See Appendix D for conflicting views.

[15] The liquidity requirement was raised from 6 percent to 7 percent on March 1, 1961. To meet the requirement, an association must maintain not less than 7 percent of withdrawable accounts in vault cash, commercial bank deposits, U.S. government bonds, and/or deposits in a Federal Home Loan Bank.

EXHIBIT 9

IBM Cards Designed by First Federal for Mortgage Loan Accounting



1 00081 3 080 1 1 01 0 009096 0177 60 008151 91 450 03057 03526 02513

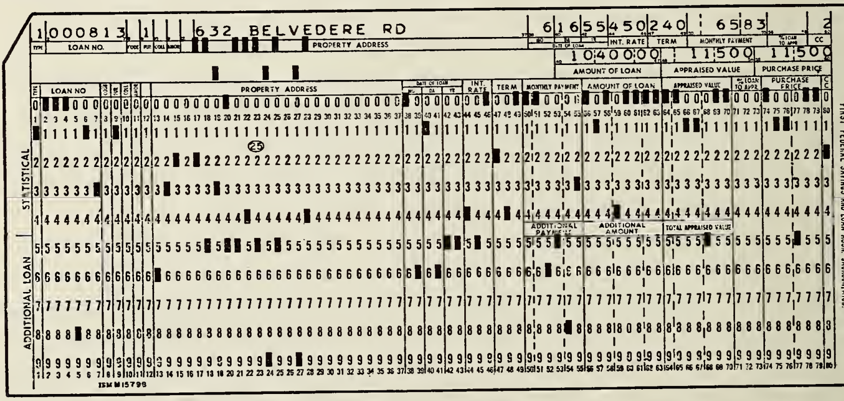
TYPE | LOAN NO. | CODE | DUE DATE MO DAY YR | TRAN. CODE | TOTAL AMOUNT | PRESENT ESCROW BAL. | PRESENT PRINCIPAL BALANCE | INTEREST RATE | INTEREST PAYMENT | PRINCIPAL PAYMENT | ESCROW PAYMENT | CARD CODE

DELINQUENT INTEREST OR ANTIC. ESCROW | ADV. OR PART. PAYMENT OR ANTIC. PRIN. BAL.

T | LOAN NO. | C | DUE DATE MO DAY YR | TRAN. CODE | TOTAL AMOUNT | PRESENT ESCROW BAL. | PRESENT PRINCIPAL BAL. | INT. RATE | INTEREST FACTOR | INTEREST PAYMENT | PRINCIPAL PAYMENT | ESCROW PAYMENT | DELINQUENT INTEREST | ADVANCED OR PARTIAL PAYMENT | TRAN. DATE MO. DAY YR. | CC

ANTICIPATED ESCROW | ANTICIPATED PRINCIPAL BAL.

MORTGAGE BALANCE
FIRST FEDERAL SAVINGS AND LOAN ASSN.—JACKSON, MISS.
IBM M15788



1 000813 1 632 BELVEDERE RD 6 1 6 5 5 4 50 2 40 6583 2

TYPE | LOAN NO. | CODE | PUR. | COLL. | AMOR. | PROPERTY ADDRESS | DATE OF LOAN MO. DA. YR. | INT. RATE | TERM | MONTHLY PAYMENT | % LOAN TO APPR. | CC

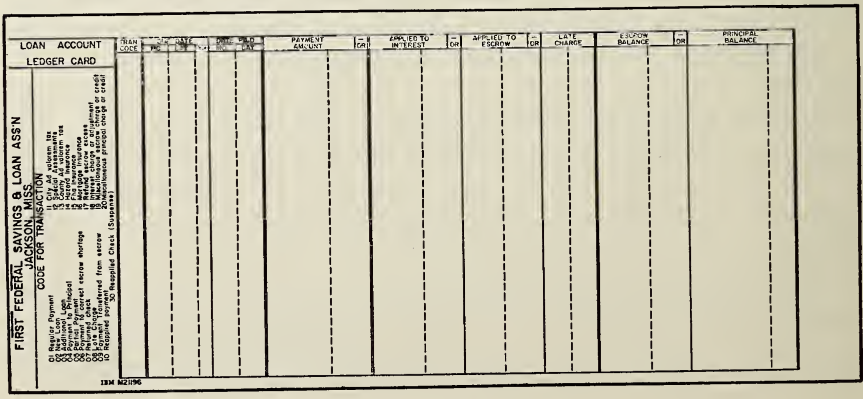
10400 00 11500 11500

AMOUNT OF LOAN | APPRAISED VALUE | PURCHASE PRICE

TYPE | LOAN NO | CODE | PUR. | COLL. | AMOR. | PROPERTY ADDRESS | DATE OF LOAN MO. DA. YR. | INT. RATE | TERM | MONTHLY PAYMENT | AMOUNT OF LOAN | APPRAISED VALUE | % LOAN TO APPR. | PURCHASE PRICE | CC

ADDITIONAL PAYMENT | ADDITIONAL AMOUNT | TOTAL APPRAISED VALUE

ADDITIONAL LOAN
STATISTICAL
FIRST FEDERAL SAVINGS AND LOAN ASSN.—JACKSON, MISS.
IBM M15796



LOAN ACCOUNT LEDGER CARD

FIRST FEDERAL SAVINGS & LOAN ASS'N
JACKSON, MISS.

CODE FOR TRANSACTION

01 Regular Payment
02 New Loan
03 Additional Loan
04 Payment to Principal
05 Partial Payment
06 Payment to correct escrow shortage
07 Returned check
08 Late Charge
09 Payment Transferred from escrow
10 Reapplied payment
11 City Ad valorem tax
12 Special Assessments
13 County Ad valorem tax
14 Hazard Insurance
15 Fha Insurance
16 Mortgage Insurance
17 Refund escrow excess
18 Interest charge or adjustment
19 Miscellaneous escrow charge or credit
20 Miscellaneous principal charge or credit
30 Reapplied Check (Suspense)

TRAN CODE	DUE DATE MO DAY YR	DATE PAID MO DAY	PAYMENT AMOUNT	— DR	APPLIED TO INTEREST	— DR	APPLIED TO ESCROW	— DR	LATE CHARGE	ESCROW BALANCE	— DR	PRINCIPAL BALANCE

IBM M21196

diately available, and a ledger card showing all transactions is automatically printed for sending to customers at regular intervals.

Regulations of the Federal Savings and Loan System were amended in 1956 to permit an insured association to employ a staff internal auditor to audit its books. Previously, only a qualified independent accountant or the Federal examiners could perform the audit. When the work of the internal auditor meets the minimum specified requirements, it will be accepted by the Division of Examinations of the Federal Home Loan Bank board. First Federal took the initiative in the Little Rock district by employing such an auditor in 1959, and, Mr. Kabbes believes, it is still the only association in the district which had done so by mid-1961.

Work papers of First Federal's internal auditor, Mr. Marion Spencer, have been examined from time to time by the Federal examiners and have been judged as sufficient in scope and detail so that full approval of the procedure has been given. In addition to a saving in auditing expenses by the Federal Home Loan Bank, Mr. Kabbes points out that there are distinct internal operating advantages. The internal auditor reports directly to the board of directors, audits departments frequently and at unscheduled times thereby encouraging alertness and integrity, and provides management with frequent reports on which policy decisions are based.

Personnel. A generally accepted standard requirement in the savings and loan business is one employee for each $1 million in savings. First Federal, however, operates with one employee for each $1.3 million, an indication of efficiency which is attributed to a favorable personnel policy.

Personnel requirements have climbed rapidly in recent years as the institution has grown, but Mr. Files emphasizes that basic personnel policies and benefits have remained fairly constant. Turnover has been a negligible factor, and "relationships between management and employees have always been good."

The normal work week at First Federal is 37½ hours, with overtime requirements occurring only during the close of each dividend period every six months. Two weeks vacation, plus the usual five holidays, is modified by a four weeks vacation in the eighth year of service, with a repeat every five years thereafter. A profit-sharing retirement fund, started in 1957, has been well received by employees.

Public Relations Policies. First Federal emphasizes in its public relations program dual concepts of service: (*a*) as a savings depository for people throughout Mississippi, and (*b*) as a leader in encouraging the economic development of the state and the well-being of its people. Primary attention is given to local community activities in the Jackson metropolitan area, but there is also considerable emphasis on stimulating a favorable state-wide image as well.

At the local level, First Federal executives undertake roles of leadership in professional and church groups, PTA, Chamber of Commerce activities, health and welfare fund-raising campaigns, and other programs of specific public interest in education, civic improvement and community development. Public relations efforts are directed also toward business and professional groups with which First Federal is in almost daily contact.

At the state-wide level, First Federal executives serve in positions of responsibility with special interest groups. Work is carried on with both private groups, such as manufacturers, timber owners and conservation organizations, the state Chamber of Commerce, and public groups including government agencies and professional societies. Mr. Files, for instance, was requested by the governor to develop and present a bill to the 1959 state legislature establishing a forestry bank to make small loans (up to $1,500) to landowners for timber improvement.

Two widely recognized examples of First Federal's public relations activities are: LET'S TALK MISSISSIPPI and FIRST FEDERAL FOUNDATION AWARDS. The first was designed to stimulate a more positive attitude among state citizens regarding the benefits and advantages offered within the state. Public speaking engagements, car decals and bumper stickers, TV slides, postage meter plates, newspaper advertising, and other devices were developed and used to promote the slogan. Later, the slogan became the title for a major committee activity of the state Chamber of Commerce, with this committee now in its third year of operating a program designed to spread positive information more widely among State citizens.

Under the First Federal Foundation Awards program, carried on in cooperation with The University of Mississippi, three outstanding citizens of Mississippi are recognized each year in spectacular ceremonies in Jackson. The awards event is presented live on television for one hour, with the governor and the chancellor of The University of Mississippi making the official presentations. Persons so recognized are selected for the magnitude of their distinguished service to Mississippi. A bronze figurine—designed in art competition among University of Mississippi students for $500 in prizes—is presented each recipient as a symbol of the honor.

A strong advertising program, embracing all types of media, is developed to accompany each public relation activity. By such means, Mr. Files believes, the maximum impact is achieved towards creating a favorable state-wide image of First Federal as a service institution aiding in the economic progress of Jackson and the state.

APPENDIX A

GENERAL FEATURES OF SAVINGS AND LOAN ASSOCIATIONS

Savings and loan associations are mutual financial institutions, privately owned, and may be incorporated under either state or federal laws. Capital is exclusively in the form of savings accounts owned by members. Such accounts may be established by any person, partnership, or corporation, with accounts owned outright or in trust. Income is obtained primarily from investments in first mortgages on homes, which for federally-chartered firms, must be within a 50-mile radius of the home office. Regulations for state-chartered institutions on the other hand vary widely.

Although the first mutually-owned building society in the United States was organized in Pennsylvania in 1831, most of the current business volume of associations results from growth since 1945. Federal insurance has been a particularly encouraging factor.

The Federal Home Loan Bank System was established in 1932 during the Hoover Administration to combat the effects of the depression upon savings institutions. Eleven regional Federal Home Loan Banks (FHLB), under a Federal Home Loan Bank Board, were chartered to make loans to qualifying firms, including building and loan associations, homestead associations, cooperative banks, and similar types.

The Roosevelt New Deal Administration expanded the Home Loan Bank System by establishing the Home Owners Loan Corporation with authority to buy share-accounts in existing state savings and loan associations. By the same act, federally-chartered savings and loan associations were authorized. Further encouragement of the savings and loan business was provided in 1934 by the creation of the Federal Savings and Loan Insurance Corporation (FSLIC).

In many respects the organizational structure of savings and loan associations resembles that of commercial banks. Charters are issued by the federal government and by all state governments. All federal associations must belong to the Federal Home Loan Bank System with each account insured up to $10,000 by the Federal Savings and Loan Insurance Corporation. State-chartered associations, as is true of state-chartered banks, may or may not belong to the Federal System, and may or may not have accounts insured. Consequently, there are four types of associations currently operating:

1. *Federal Association.* A charter is issued by the federal government and the association is automatically required to belong to the FHLB System and the FSLIC. About 30 per cent of all associations in 1960 were of this type, owning 53.9 per cent of total assets.

2. *State Association, FHLB Member, Insured by FSLIC.* The association is chartered by a state, but complies with all federal provisions, is a FHLB member, and accounts are insured on the same basis as federal associations. Numerically, 35 per cent of the associations are thus classified, with ownership of 4.0 per cent of assets.

3. *State Association, FHLB Member, Not Insured.* A state-chartered association which meets requirements for membership in the FHLB System, but does not have accounts insured with the FSLIC. Only 8 per cent of associations, with 3 per cent of assets, are of this type.

4. *State Association.* State-chartered associations which are not affiliated with the FHLB System in any way comprise 27 per cent of the total number, but control only 3 per cent of all savings and loan association assets. Such associations in many states have less legal restrictions on operations than do FHLB members, and frequently advertise "insured accounts" even though the insurance is with a privately-owned, State-chartered company.

In order to be eligible for FHLB membership, an association must be "duly organized under the laws of any State or of the United States, be subject to examination and regulation by any State or by the United States, and make

TYPES OF SAVINGS AND LOAN ASSOCIATIONS
($000,000 Omitted)

Type	*1960 Number of Associations*	*1960 Total Assets (Dollars)*	*1955 Number of Associations*	*1955 Total Assets (Dollars)*	*1950 Number of Associations*	*1950 Total Assets (Dollars)*	*1945 Number of Associations*	*1945 Total Assets (Dollars)*
I. Insured by FSLIC								
1. Federal associations	1,873	38,511	1,683	20,035	1,526	8,457	1,467	3,921
2. State-chartered associations	2,225	28,919	1,861	14,163	1,334	5,234	1,008	2,202
Total insured	4,098	67,430	3,544	34,198	2,860	13,691	2,475	6,123
II. Nonfederally insured								
3. State associations with membership in FHLB system	596	2,095	763	1,949	1,034	1,825	1,183	1,558
4. State associations without membership in FHLB system*	1,582	1,964	1,764	1,509	2,098	1,377	2,491	1,066
Total noninsured	2,078	4,059	2,527	3,458	3,132	3,202	3,674	2,624
III. Total, all associations	6,276	71,489	6,071	37,656	5,992	16,893	6,149	8,747

* In Massachusetts, all state associations are insured by the Cooperative Central Bank of Massachusetts.
Source: Calculated from *1961 Source Book, Savings and Home Financing, Federal Home Loan Bank Board,* and the *1961 U.S. Savings and Loan League Fact Book.*

long-term home mortgage loans. Each applicant shall also be, in the judgment of the Board, in satisfactory financial condition and the character of its management and its home financing policy shall be consistent with sound and economical home financing."

Supervision by state governments ranges from close control to no control. Some states have regulations similar to those applicable to federal savings and loan associations, while others have no restrictions except those applicable to corporations in general. In Massachusetts, for example, all associations are closely supervised. No specific legal restrictions apply in Mississippi on the establishment of branch offices, on the per cent of appraisal which may be covered by a mortgage, on the maximum amortization period, or on security requirements for individual loans.

In Mississippi, 70 savings and loan associations were operating at the close of 1960, of which half were insured and half uninsured. Federally-insured associations represented 94 per cent of the total association assets of $298 million.

APPENDIX B

MEMBER'S ADVICE TO FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION
Jackson, Mississippi

1. My latest deposit in First Federal was made about ____________ in ____________.
(month) (year)

2. This deposit was made (check one):
☐ In person by me. ☐ By mail. ☐ By someone else.

3. If you made the deposit in person, did you go downtown that day (check one):
   - ☐ Especially to visit First Federal.
   - ☐ Because you work downtown.
   - ☐ To shop at (name of store or stores)____________________.
   - ☐ To discuss business at______________________________.
     (name of building)
   - ☐ Primarily for this reason:___________________________.
4. If you made the deposit in person, how did you get downtown? (Check one)
   - ☐ By bus. ☐ Walked.
   - ☐ By private car, which was parked at_____________________.
   - ☐ Other (please describe)_____________________________.
5. I live in: ☐ In Jackson (please give postal zone number)_____________.
   ☐ Outside Jackson, in________________________________.
   (name of town or community)
6. I work in: ☐ Downtown Jackson (address)_______________________.
   ☐ Jackson, outside downtown area.
   ☐ Outside Jackson (name of locality)_____________________.
7. I suggest that First Federal can improve its service to me by:______________
   ____.

Thank you for your help. If you are willing (it's not required), you may add in the following: (Note that no signature is specifically sought.)

I estimate my current First Federal savings balance is:

a below $100 ☐ *c* $500–$999 ☐
b $100–$499 ☐ *d* $1000–$4999 ☐ *e* $5000 or more ☐

Please mail back today in the accompanying stamped, self-addressed envelope. We need your views as soon as possible.

APPENDIX C

SUGGESTED PROCEDURE FOR TAKING FHA APPRAISAL REQUESTS ON EXISTING CONSTRUCTION

First Federal Savings and Loan Association
Jackson, Mississippi

I. For Conditional Commitment.
   1. Get 3 FHA Forms 2004 from filing cabinet.
   2. Home owner, or agent, should answer questions indicated on form. They are also required to sign forms in space indicated at the bottom.
   3. Starting at the top of the FHA Form 2004, fill in the blanks with pen or pencil for a rough draft.
   4. After the rough copy has been filled out, get the owner, or agent, to sign 2 blank forms. These shall later be executed by typing them as the rough draft has been filled out.

II. Steps in Filling Out the FHA Form 2004 for Conditional Appraisal Request.
   1. Check Conditional (Type Commitment).
   2. (4) Check Section of Act.

      203-B pertains to FHA properties that exceed $9,250 in appraised value.

      203-I pertains to properties that are appraised at $9,250 or less.

      222 pertains to an in-service loan, which is a loan made to a person who is in the Armed Services on active duty. (The FHA Insurance premium is paid by the Government as long as they remain on active duty.)

3. (5) Number of Living Units (Number of Families).
4. Month and Age of Property.
5. (6) Name of Mortgagor—Unknown, since this is a conditional commitment.
6. Proposed Sales Price.
7. Principal Amount of Loan—Always *HIA* (Highest Insurable Amount).
8. Interest Rate—5½% (This is the maximum allowable rate authorized by FHA).
9. Monthly Installments—360 for 30 years; 300 for 25 years.
10. (7) Property Offered for Security—address.
11. (8) Legal Description (VERY IMPORTANT). This is reflected on the deed and, if it is a lengthy description, should be copied verbatim.
12. (13) Lot Dimensions (Very Important).
13. (14) Number of Rooms—list baths separately.
14. (16) Water Supply System: public, community, individual.
15. (17) Real Estate Taxes (Very important to get best estimate possible).
16. (18) Special Assessment Data: if there are any outstanding assessments, it is well to obtain the approximate amount.
17. (19) Estimate Hazard Insurance (estimate coverage; refer to schedule for Insurance).
18. (20) Name of Occupant—ALWAYS PUT NAME OF OWNER IN THIS SPACE.
19. Generally, it is best to advise them to call before inspection. Get both business and home telephone numbers, if the owner is employed.
20. After rough draft has been completed, collect $20.00 for the FHA appraisal fee. The check should be made payable to First Federal Savings and Loan Association. If they give you cash, you should give them a receipt out of the Receipt Book.
21. After the owner or agent has signed the two blank forms, you can then advise him that the inspector will call before coming out, and when we receive the FHA Report, he (owner or agent) will be advised by telephone concerning the loan amount, appraised value, repairs, if any are required, and the terms. (Generally, it takes 2 to 3 weeks to hear from FHA. This time varies as their work load increases or decreases.)
22. Get owner to sign Brokerage Statement on blank indicated—list the present Mortgagee and the owner's or agent's telephone number.
23. After the owner or agent leaves, or later in the day, you are ready to process request.

III. How to Process the FHA 2004—Request for Appraisal:

1. Make up White Payment Slip, reflecting the following:
   Account No.:
   Name Space: FHA Loan Cost
   Street Space: Owner's Name
   Date:
   After this is done, attach check or cash to slip and place in large box on Ann's desk.
2. Make up a 3″ x 5″ card reflecting the following: Name, street, person who paid appraisal fee, and date paid in and paid out (generally the same day).

3. Type up FHA forms on forms that have been signed, and two 2004-K forms which accompany one copy of the Form 2004. Place these forms, along with the card on Joyce's desk. She will write check to FHA at end of day.
4. Build a folder to keep information in as follows:
    1. Place blue tab reflecting owner's name and legal description on reports that exceed $9,250 in appraised value.
    2. Place green tab on reports that are $9,250 or less in appraised value. (The Mortgagee obtains ½ of 1% extra as a service charge on any FHA loan that is $9,000 or less.)
    3. Clip NEED FOLLOWING FORM (BROKERAGE SCHEDULE) to inside cover of folder.
    4. Place folder in drawer marked "Loans Awaiting FHA Approval," top front of middle cabinet—folders are filed alphabetically.

APPENDIX D

DILLON ASKS CONGRESS TO INCREASE TAXES GRADUALLY ON SAVINGS AND LOAN INSTITUTIONS*

WASHINGTON—Treasury Secretary Dillon asked Congress to impose higher taxes on mutual savings banks and savings and loan associations. But he suggested the higher levies be imposed gradually to avoid pinching the flow of housing credit.

The Kennedy Administration's long-awaited proposals on the controversial topic were contained in a letter from Mr. Dillon to Chairman Mills (D., Ark.) of the House Ways and Means Committee. The proposals, although watered down in several weeks of inter-Administration debate, were immediately denounced by spokesmen for savings and loan associations.[1] Spokesmen for commercial banks applauded the message.

Mr. Dillon did not advocate a specific formula for higher taxation of the mutual thrift institutions, but he did suggest some alternative plans for Congress to choose from. One plan eventually would yield the Treasury about $500 million a year in extra revenues; another would produce about $150 million annually.

Quick action by Congress is rated as unlikely, partly because of the Treasury's take-your-choice approach. Also, the taxwriting Ways and Means Committee is busy with the Administration's general tax bill, and is scheduled to take up this month the proposal for Federally financed medical care for the aged. Finally, savings and loan groups plan a stiff fight in Congress. "We are confident Congress will reject the Treasury suggestions," said C. Elwood Knapp, president of the U.S. Savings and Loan League.

Bad Debt Chance Asked. Mr. Dillon asked that Congress alter the present rule which allows mutual thrift institutions to make tax-free transfers of earning to their bad-debt reserves. These transfers can be tax-free as long as the reserves do not exceed 12 per cent of a concern's savings "deposits." Because of this rule, Mr. Dillon said, the more than 6,700 mutual savings banks and savings and loan associations paid only $8,800,000 in Federal income taxes in 1958, the last year for which complete figures are available.

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* *The Wall Street Journal*, July 17, 1961.

[1] Mr. Kabbes of First Federal points out that Mr. Dillon in his recommendation appears to ignore the "differences between the capital structure of savings and loan associations and commercial banks. Depositors in a commercial bank are protected by capital stock, surplus, and undivided profits as well as by the reserve for bad debts. Savings and loan associations, on the other hand, do not have capital stock, and the margin of safety for savings account owners is provided exclusively by the reserves."

Mutual thrift institutions say this rule allows them to build sufficient reserves to guard savers against loss on defaulted mortgage loans. But the Treasury's report said this and other arguments "no longer seem sufficient to justify a special tax treatment amounting to virtual tax exemption."

Mr. Dillon noted that commercial banks can make tax-free transfers of earnings to reserves until the reserves equal about 2.4 per cent of their outstanding loans. He said a comparable formula for mutual thrift institutions would restrict tax-free transfers to 2 to 3 per cent of those outstanding loans not backed by Government repayment guarantees. Immediate imposition of this "full taxation" formula, the Treasury calculated, would produce revenues of $378 million in 1962. As the thrift institutions grew, the formula would produce estimated revenues of $503 million by 1965.

Both the Housing and Home Finance Agency and the Federal Home Loan Bank Board have warned the Treasury this plan would hurt home construction. Higher taxes, it's argued, would force thrift institutions to reduce their dividend rates to savers. This, in turn, would reduce the flow of savings available for home construction loans.

Mr. Dillon conceded any change in the tax formula "must be weighed in the light of its possible adverse effect" on housing. Even so, he said, "additional tax revenue can be obtained at this time without significant disruption to the mutual thrift institutions or impairment to National housing programs."

Stretch-Out Plan Offered. He said if Congress is worried about the impact of "full taxation," the plan can be applied gradually over a four-year period. This stretch-out formula would yield an estimated $75 million in revenues in 1962, gradually rising to $549 million in 1966.

And Mr. Dillon said if Congress decides a "full taxation" formula of any kind is too harsh, "consideration might also be given to an alternative formula." This plan would tax the theoretical investment earnings of money set aside in bad-debt reserves. Such a "partial taxation" formula, he said, would produce between $125 million and $150 million of extra revenue yearly.

The message drew general praise from commercial banking circles, which have long demanded higher taxes for competitive thrift institutions. "Our general reaction is one of great gratification and pleasure," said an official of the American Bankers Association.

But savings and loan association men were sharply critical. Declared Mr. Knapp of the U.S. Savings and Loan League: "It will ultimately mean a reduction of from $5 billion to $6 billion in funds available for home lending from savings and loan associations, which would produce a real crisis in the home mortgage and real estate markets, curtail home building and real estate activity, and could well trigger a serious recession in the next few years."

Gerrit Vander Ende, president of the National League of Insured Savings Associations, said the Treasury's suggestions "could curtail annual output of new housing by more than 100,000 dwellings."

Dixie National Bank[*]

The Dixie National Bank was located in a growing industrial Southern city. In addition to its large industrial and commercial lending activities, it still attempts to service the credit needs of the agricultural area surrounding the city. As it became predominantly a "city" bank, it lost touch with agricultural borrowers and increasingly was forced to make these loans through its correspondent banks located not only in the state but throughout the South. While the Dixie National Bank is not particularly noted as a "progressive" bank, it is quite aggressive and competes fiercely with other banks in the city for deposits and good loan accounts. Since it acts as a "correspondent" it feels that solicitation of deposits from large national companies with Southern operations fits naturally into its activities. Despite the rapid growth of the industrial community in recent years and the declining importance of the agricultural and rural community, the Dixie National Bank still feels strong ties to the rural area and its economic and financial problems.

Howells Cobb is a typical product of his state. He grew up in a small rural county seat and was graduated from the state university and its law school. Tiring of the struggle to establish a legal practice in his home town, he was glad to accept a position in a bank in the large metropolitan area as an executive trainee. He advanced rapidly and in 1958 he switched banks, taking a position as vice-president of the Dixie National Bank with the responsibility of control over agricultural loans.

Because of Dixie's strong development of correspondent banking, credit files are often built up on borrowers who are not direct customers of the bank. The bank had built up such a file on the L. Flaire Enterprises because there had been an increasing number of inquiries from all over the South concerning the credit worthiness of this company.

Leroy Flaire is almost a prototype of the American ideal. He is a completely self-made man who from obscure beginnings had created singlehandedly the largest chicken hatchery in the world. Despite his unkempt appearance, his poor speech, and an almost complete lack of formal education, Leroy Flaire is known by the industry as the greatest hatcheryman in the business.[1] Hatcheries under his management reputedly had higher hatch proportions than industry averages and he was known to have improved broiler chicken breeding strains through his own breeding experiments.

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[*] Prepared by R. R. Dince, College of Business Administration of the University of Georgia.

[1] Poultry husbandry is an exacting science generally under the control of university trained scientific research personnel. The goal in breeding has been to create a broiler chicken which will produce high quality meat at the lowest possible feed conversion ratio.

One of the most rapidly growing agricultural industries in the United States and particularly in the South has been the broiler industry. (See Exhibit 1.) The basis of the growth can be traced to the fact that broiler meat is relatively inexpensive in comparison to other meats. Using sound managerial techniques, the production of broilers becomes somewhat like that in a factory and is not like other types of farming. Because broiler raising resembles factory production, the industry has tended to locate in areas of redundant farm labor and marginal farms. Since it is a labor-intensive industry requiring year-round labor, with land quality having no bearing on production, the southern piedmont has emerged as a natural area for growth. Because of relatively low labor costs, it is more economical to ship small grains from the Midwest into the South to be processed into feed than it would be to raise the chickens nearer the cheaper grain areas.

EXHIBIT 1

Broiler Production in Selected States, 1955–58
Number Produced (000 Omitted)

	1955	*1956*	*1957*	*1958*
North Carolina	72,936	94,087	106,352	134,185
Georgia	177,642	222,780	261,000	292,119
Alabama	57,764	82,085	103,875	130,024
Mississippi	37,486	52,855	66,597	85,424
Arkansas	76,954	99,271	110,191	133,331
Delaware	69,820	85,699	93,537	94,250
Maryland	58,367	67,033	74,288	86,209
Indiana	32,368	38,518	42,370	44,912
California	48,516	52,397	43,490	47,839
Total for 22 states	959,681	1,192,822	1,303,397	1,496,864

Source: Agricultural Marketing Service, United States Department of Agriculture.

The one important factor concerning the poultry industry—any phase of the industry—is that it requires huge sums of working capital; chickens must be produced in large quantities to keep costs down. This problem of raising capital to finance the relatively short production cycle has plagued the industry from its inception, particularly as competition between individual producers and producing areas has lowered prices and profits. The industry has reacted to lower profits by intensifying the drive for lower costs through even greater production, in this way increasing the need for credit.

So far as a hatchery is concerned, its need for financing arises from two sources. First, often it is asked to extend trade credit on the sale of its baby chicks. While this credit is supposed to be turned over in 30 days, often the hatchery has to wait until the chicks have been raised to marketable size before receiving payment. If the hatchery is not a custom hatchery—processing someone else's eggs—then an additional and more important need for credit arises out of the necessity for maintaining its own laying flocks. In order to have highly productive laying flocks, it must always have flocks being raised in preparedness to replace existing flocks. Typically these birds are financed in two ways. As pullets and cockerels, the feed and chick costs are financed by giving notes secured by the birds themselves. These notes are replaced with new notes when the birds reach laying size to cover the feed costs necessary to maintain the flocks while they are laying for the hatchery. The general rule of thumb is that credit should not exceed the meat value of the breeding flocks, approximately $1.25 per bird.

It seemed that there had been an unusually large number of requests for depositors and correspondent banks in the spring of 1959 concerning the credit standing of the Flaire Enterprises. So far as Howells Cobb knew there was little reason to believe that any significant change either in the Flaire companies or the problems of the poultry industry itself warranted any change in the bank's advice. Almost uniformly, he counseled banks and others to be extremely wary about extending too much unsecured credit to Flaire or any of his enterprises unless proper security for the loan could be secured. While Flaire did not file any specific credit information with Dun and Bradstreet or other credit agencies, credit reports were generally derogatory but not specific. The major point to be drawn from the credit report was that Flaire with his many companies, while a dominant factor in the industry, was generally known as a slow payer—though no one had ever actually lost any money on a Flaire receivable.

It was just after Mr. Cobb had answered a credit inquiry in July 1959 regarding Flaire that the Dixie National Bank was asked by its correspondent bank in Winton to participate in a loan to one of the Flaire companies. Mr. Cobb, while naturally reluctant to make such a loan, felt that at least he had to receive and discuss the credit application. An appointment was made for Mr. Cobb to meet with Winton bank officers and Mr. Flaire. At the meeting, Mr. Cobb was introduced to Mr. Flaire, and to Mr. Joyce, who had just been named president of the major Flaire companies, and to Mr. Pine, who had joined the companies with Joyce and was now vice-president and treasurer. Considering that he and his bank had formed a rather adverse surface opinion of Flaire, Mr. Cobb questioned the trio of company officers closely to get a clearer picture of the size and scope of their operations. Cobb knew Flaire to be the largest hatchery operator in the world, but he did not know the complete scope of the operations.

Mr. Flaire presented the facts of the operation. There were three major Flaire companies. The three major corporations were not the apex of a pyramid, but were merely the largest companies in the Flaire group.

Flaire, Inc., was a completely separate operation; it was the most recently founded company and was devoted solely to the hatching of Leghorn laying hens. Flaire's Hatchery actually was the center of the broiler hatching business; in essence it was the production unit. Winton Hatcheries did little or no hatching; this corporation owned the laying flocks and produced the eggs used by Flaire's Hatchery and other hatchery units. The twenty-four or more smaller corporations were not all producers of hatching eggs or hatchery units. Many of them were sales corporations owning almost no assets and transacting little except book transactions for other Flaire corporations. As the sales effort grew, the smaller operations were founded to feed the expanding market, but the major reason separate entities were formed for each new expansion apparently stemmed from an attempt to get an income tax advantage by dividing up the total business in such a way that no single corporation would show more than $25,000 profit.

It is not exactly clear how rapidly the Flaire complex grew, but by the beginning of 1959 consolidated sales were in excess of $10,000,000. From the several hundred dollars of borrowed capital, Flaire now controlled corporations which had total assets of over $10,000,000 with an estimated net worth of over $2,000,000. He controlled over 2,000,000 chickens[2] and was producing over 140,000,000 baby chicks a year. While there were several hundred employees of all the organizations and each hatchery had a manager, the whole operation was under the control of Flaire and his major assistant, Joseph Prince. In order to expand output as rapidly as possible with minimum working capital, a maximum use of credit of every type was necessary.

In his questioning of Flaire, Mr. Cobb asked for some financial information. Flaire handed him a balance sheet dated March 31, 1959, and said that this covered the corporation that desired to make the loan. (See Exhibit 2.) Cobb asked to see a consolidated statement, but he was told that the accountants had not yet pulled one but that he would receive a copy when it was available. Cobb questioned Mr. Flaire further on the various items and found that Flaire used heavily the sale lease-back technique. All vehicles used by the corporation were leased—these included officers' cars, chick buses, and four light planes. Flaire had over 200 incubators in use; while payments had been completed on some of them, incubator lease payments annually were running in excess of $250,000. Almost all of the incubator leases were taken out personally by Mr. Flaire; the payments on the leases, however, were made by the hatcheries either directly or indirectly. The huge buildup in breeding flocks needed to service the incubator space available required Flaire to enter into agreement with

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[2] Breeding flocks. Breeder hens have a useful laying life of seven months after reaching maturity; therefore new flocks (now productive) must always be ready to replace inefficient flocks.

EXHIBIT 2

Flaire's Hatchery, Inc.
Statement of Financial Condition*
(Cents Omitted) March 31, 1959

ASSETS			
Current assets			
Cash on hand and in bank			$ 4,044
Accounts and notes receivable			
Customers		$449,414	
Related companies		431,937	
		881,351	
Deduct provision for doubtful accounts		30,955	850,396
Inventory—Eggs			17,790
Total Current Assets			$ 872,230
Officers and employees account receivable			343,049
Cash value life insurance			3,600
Buildings and equipment—Net			101,460
Other assets			
Receivables from old partnerships and proprietorships controlled by L. A. Flaire —Liquidating		$205,334	
Other miscellaneous assets		8,333	213,667
Total Assets			$1,534,007
LIABILITIES AND CAPITAL			
Current liabilities			
Accounts and notes payable			
Banks			$ 123,234
Trade			107,416
Related companies			1,042,450
Payroll taxes			1,020
Accrued expense			317
Total Current Liabilities			$1,274,438
Capital stock		$216,500	
Retained earnings			
Balance—September 30, 1958	$28,259		
Net income for six months ending March 31, 1959	14,810	43,069	259,569
Total Capital and Liabilities			$1,534,007

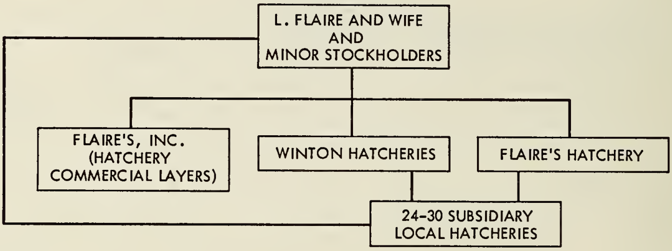
* Not certified.

farmers who had capital available whereby the Flaire companies leased farms and the equipment necessary to maintain large breeder flocks.

Over the years Mr. Flaire had built up an organization which produced a substantial portion of the total hatch of broiler eggs in the United States. Mr. Flaire in running his business occupied himself solely with the problems of output and sales, leaving much of the internal financial operations to a $100-a-week bookkeeper. He admitted that in his drive to expand he had ignored the internal organization of his business. In building up his production and sales effort, Flaire formed well over two dozen subsidiary corporations located in various poultry production centers. Flaire owned all or almost all of the stock in the subsidiary corporations, but several of the subsidiaries were in great part owned by the three master corporations. (See Exhibit 3.)

Mr. Flaire had to leave the meeting early saying that he had to fly to Texas to supervise the beginning of a new hatchery. Mr. Cobb continued his discussion with Mr. Joyce and Mr. Pine. Frankly, he was quite interested in their role in the business and how they had become chief officers of the consolidated Flaire enterprises. Mr. Joyce explained that he had been brought into the Flaire picture in February by a group of the major creditors of Flaire led by the Hooker Corporation, a large national feed company. The worsening poultry and egg market compounded by the confused state of Mr. Flaire's corporate and personal affairs had prompted these creditors to insist that Flaire bring in some outside management help. Mr. Joyce and his staff, acting as consultants, submitted a report in May. After the report was rendered, Mr. Flaire voluntarily stepped down as chief executive officer, becoming operations manager, and with the approval of his creditors named Joyce and Pine as the new top management. The major function of the new management team was to make the management report effective. A condensed version of the report follows:

EXHIBIT 3



THE MANAGEMENT REPORT

The following six general observations are made:

1. No integrated policy in force for the business as a whole.
2. Functions not clearly segregated and authorities and responsibilities not clearly established or delegated.
3. Decisions made on basis of tax savings without paying attention to effort on operations, organization, and costs of production.
4. Horizontal expansion carried on without analysis of markets. Vertical expansion carried on without appraisal of costs.
5. Necessity of disposing of perishable product has the effect of producing an emergency attitude in the organization. Marketing not orderly.
6. There is little evidence that the operation is assuming the proper responsibility for leadership in the industry.

A. Corporate and Departmental Organization.

It is recommended that complex of corporations be merged into one unified corporation, unless an evaluation of tax savings versus intangible and tangible operating costs prove tax savings devices worthwhile. It is recommended that personal proprietorship in the complex be abandoned. The present division of functions, duties, and responsibilities is vague, resulting in top management having to make decisions which should properly be made at the departmental level. These departments have not been established nor have clear lines of communication and authority been laid down.

B. Sales.

Broiler chick sales should be under the control of the individual hatchery managers except for the separate operation of Flaire's, Inc. It is recommended that chick sales and hatchery operations be clearly separated. Sales territories should be established and competition between hatcheries should be eliminated. Excess egg, culls, and cracks sales should be taken away from individual salesmen and should be turned over to a sales department.

C. Hatchery Operations.

Hatcheries would become more efficient if more attention paid to operations rather than sales. Costs would fall and hatchability percentages would rise. Hatcheries should not determine their own production but should do so in accordance with a sales projection.

D. Farm and Flock Operations.

There should be a separate department controlling and coordinating this important activity. This department would control size of flocks on the basis of the now non-existent sales forecast of chicks.

E. Employee Relations.

A formal personnel department should be organized to determine salary schedules, conditions of employment, job evaluation, job description, and fringe benefits.

F. Finance.

The accounting and internal controls systems is under revision, but it cannot be accomplished until corporate reorganization along the lines in the report have been completed. The objective of the finance department is to provide an adequate accounting system which can provide accurate current operating results and statements of financial condition, the basis of which, budgeting and financial planning can then be put into effect. None of these goals are now being accomplished.

Concluding Recommendations. All further expansion, either horizontally or vertically, should be abandoned until the organization of the business is rationalized. It is further recommended that an expert management consultant be hired and given the authority to put into effect the plan outlined in the report. Further, a controller with cost accounting experience and experience in negotiating long- and short-term loans should be hired immediately.

After looking over the management report and listening to explanations from Mr. Joyce and Mr. Pine, Cobb felt relieved concerning the affairs of the Flaire Enterprises since the rather loose administration of Flaire himself was to be replaced with "rational" management. With a little more interest, he asked Mr. Joyce exactly how much credit Flaire's Hatchery, Inc., wanted. At this point the representative of the correspondent bank interrupted to explain that this particular credit was to be like many others his bank had made to Flaire. The initial credit line was to be $250,000 split evenly between the two banks. The loans were to be made in the form of discounted notes arising out of Flaire's Hatchery's shipping baby breeding chicks to contract farmers. Farmers sign the notes for the chicks and Flaire's Hatchery endorses them, making them two-name paper. When the chicks reach the age of approximately 12 weeks they are shifted from the first contract farmer to another who raises the birds until they are laying age and then cages them and sells the eggs under contract to one of the Flaire hatcheries. When the pullets and cockerels are shifted, the old note is paid off and a new one written by the succeeding contract farmer and again endorsed by the Flaire's Hatchery. The second note, which runs for nine months, covers most of the useful laying life of the hen and is to be written in the amount of a dollar a bird. At maximum size the bird would weigh six to eight pounds and would have a rough collateral value as meat worth at least $1.44. (The Winton banker pointed out here that hens rarely sold for less than $0.24 a pound live.)

Howells Cobb said before leaving the meeting that he would be happy to present the information to his board but that he could not commit the Dixie National at this time. The officer of the Winton bank accompanied Cobb out of the room and privately urged him to make the loan. He pointed out that his area was dependent on the poultry industry and Flaire was one of the most important people in the industry. He further argued that the Dixie should make every effort to help the rural areas, particularly in situations where its correspondents wanted to make loans. When Cobb expressed his doubts about Flaire personally, the Winton bank man answered quickly, "Well, we have never lost a dime with him—and don't forget Flaire's is the largest hatchery in the world. Besides, nobody has ever lost anything on a loan collateralled by a chicken." Cobb, impressed by the correspondent's fervor, said that he would think it over but he could not make a decision until either Flaire or Joyce sent him a consolidated statement which would show the condition of the other Flaire companies.

The next morning Cobb received a telephone call from Mr. Gordon Cotler, vice-president in charge of poultry feed sales for the Hooker Corporation. He told Cobb that Flaire had called him before leaving town and had suggested that Cotler get in touch with the Dixie National Bank regarding the proposed loan. Mr. Cotler outlined his company's relationship with Leroy Flaire. The Hooker Corporation had been seeking methods of expanding its sales in the South when Mr. Flaire made a proposition to use Hooker feed exclusively in areas where Hooker could supply it on competitive terms. Considering the number of chickens under Flaire's control, this amounted to a market of approximately 60,000 tons of feed a year. Figuring conservatively, this would mean an annual volume of sales of at least $4,500,000. Mr. Cotler reminded Cobb that Flaire was the largest and most successful hatchery operation in the United States and the Hooker Corporation was happy to service this customer and provide the various Flaire companies with a total credit line of $1,000,000. Then Cobb asked Mr. Cotler if his company thought so much of Flaire's ability, why had Hooker led the group of creditors in insisting that a management study be made; and when it was completed, why had Hooker forced Flaire to appoint outsiders to top executive positions in his own company. Mr. Cotler answered by saying that the Flaire companies were so tangled up in intercompany transfers and relationships the appointment of skilled executives would give Mr. Flaire more time to devote to hatchery and breeder flock operations. Mr. Cotler pointed out that Southern banks should be in the fore-front of promoting the economic development of the South. He added, "Listen, if he's good enough for us to sink a million bucks into, why are you dragging your feet?" Mr. Cobb remained noncommittal and said that his hands were tied in the matter and that he would have to take the loan up with the Bank's executive vice-president and the loan committee. In any case, he said that he couldn't do a thing until he received more detailed financial information. Howells Cobb reminded Mr. Cotler that he couldn't check the credit of every small farmer who put his name on a note, and added, "Maybe the Winton bank could, but so far as I'm concerned, the whole thing depends on Flaire's current credit standing."

The next morning Howells Cobb went in and talked the Flaire situation over with his executive vice-president, Mr. Dennis Craig. Cobb pointed out that so far he had little inclination to make the loan. Mr. Craig listened sympathetically and then said that this "little loan" had certainly stirred up a lot of interest. He commented that he had received a call from the president of the Winton bank asking about the Dixie's decision. Mr. Craig then rather pointedly reminded Howells that the Hooker Corporation maintained large deposit balances in both the Dixie National Bank and the Winton bank. He made no further comment.

About a week later Mr. Cobb received three statements from Mr. Pine of the Flaire companies. (See Exhibit 4.) In his letter Mr. Pine said that the income statements were still in the process of being worked up and the accountant could not promise a definite date. Pine called attention to the fact that while the statements of the three companies were not certified they were prepared by an outside auditing firm.

That afternoon Howells Cobb was called out of town on important bank business. He gave the new information to Mr. Craig and ventured the opinion that he was still not sold on the idea, particularly in view of the state of the market for broilers and eggs. (See Exhibit 5.) Mr. Craig thanked him and said that the loan committee would discuss the matter that week.

EXHIBIT 4

WINTON HATCHERIES, INC.
Statement of Financial Condition
June 30, 1959

ASSETS

Current assets		
Cash on hand and in bank		$ 125,658.72
Accounts receivable:		
Customers	$ 800,163.11	
Related companies	3,067,887.15	
	$3,868,050.26	
Less provision for doubtful accounts	80,016.31	3,788,033.95
Inventory		2,568,356.83
Total Current Assets		$6,482,049.50
Officers' and employers' accounts:		
L. A. Flaire	$ 36,974.65	
Payments made on equipment, charged to L. A. Flaire during fiscal year	47,987.45	84,962.10
Cash value life insurance		3,600.00
Fixed assets—net		14,209.05
Other assets		
Accounts receivable due from old partnerships and proprietorships controlled by L. A. Flaire—Liquidating	$ 295,608.15	
Investment—Flaire's Breeder Farm, Inc.	1,054,716.86	
Deposit	425.00	1,350,750.01
Total		$7,935,570.66

LIABILITIES AND CAPITAL

Current liabilities		
Accounts payable		
Outside creditors	$2,956,142.88	
Related companies	1,268,584.19	$4,224,727.07
Notes payable		1,825,973.23
Accrued expenses		6,285.00
Total Current Liabilities		$6,056,985.30
Capital		
Capital stock issued	$ 65,000.00	
Less treasury stock	20,478.67	
Capital stock outstanding	$ 44,521.33	
Retained earnings	$1,834,064.03	$1,878,585.36
TOTAL		$7,935,570.66

EXHIBIT 4 (*Continued*)

FLAIRE'S HATCHERY, INC.
Statement of Financial Condition
June 30, 1959

ASSETS

Current assets			
Cash on hand and in bank			$ 3,667.54
Accounts and notes receivable			
Customers		$ 374,774.23	
Related companies		215,841.98	
Notes receivable		196,127.62	
		$ 786,743.83	
Less: Provision for doubtful accounts	$230,302.27		
Notes receivable discounted	125,614.47	355,916.74	430,827.09
Inventory			14,905.14
Total Current Assets			$ 449,399.77
Officers and employees			
L. A. Flaire		$ 241,338.42	
Undistributed expenditures for various Flaire companies charged to L. A. Flaire during fiscal year		275,363.47	535,981.34
Fixed assets—At cost less accumulated depreciation			114,830.57
Other assets			
Receivables from old partnerships and proprietorships controlled by L. A. Flaire—Liquidating		$ 196,297.43	
Deposits and prepaid expenses		8,426.18	
Cash value of life insurance		3,600.00	208,323.61
Total			$1,308,535.29

LIABILITIES AND CAPITAL

Current liabilities		
Bank overdraft		6,070.66
Accounts payable		
Outside creditors	151,385.75	
Related companies	1,101,240.71	1,252,626.46
Notes payable		811.92
Accrued expenses		800.46
Total Current Liabilities		$1,260,309.50
Capital		
Capital stock outstanding	216,500.00	
Retained earnings (Deficit)	(168,274.21)	48,275.79
Total		$1,308,535.29

EXHIBIT 4 (*Continued*)

FLAIRE'S, INC.
Statement of Financial Condition
June 30, 1959

ASSETS

Current assets			
Cash on hand and in bank			$ 23,596.26
Accounts and notes receivable			
Customers		$821,356.88	
Related companies		1,013.80	
Other		34,575.74	
		$856,946.42	
Deduct:			
Notes receivable discounted	$594,028.14		
Reserve for bad debts	50,264.00	644,292.14	212,654.28
Inventories			500,016.17
Total Current Assets			$736,266.71
Officers and Employees Accounts			16,642.78
Fixed Assets—Net			4,704.26
Subscription to Capital Stock			1,000.00
Total			$758,613.75

LIABILITIES AND CAPITAL

Current liabilities		
Accounts and notes payable		
Banks		$ 53,200.00
Trade		293,976.58
Related companies		366,321.42
Other		8,176.63
Total Liabilities		$667,674.63
Capital		
Capital stock	$ 1,000.00	
Retained earnings	89,939.12	90,939.12
Total		$758,613.75

EXHIBIT 5

GEORGIA CHICK PRICES
1958 and 1959*
Broilers, price per pound, North Georgia

	1958			*1959*		
	Broilers (Price per 100 Chicks)	*Layers*	*Live Brailers (Price per Pound)*	*Broilers*	*Layers*	*Live Broilers (Price per Pound)*
January	13.5	38.0	17.1	8.8	38.0	14.6
February	14.0	40.0	19.0	9.2	41.0	15.1
March	14.0	40.0	21.0	8.3	41.0	15.5
April	14.2	40.0	19.2	6.7	40.0	15.8
May	13.8	40.0	20.0	7.2	40.0	14.9
June	13.8	38.0	20.0	8.7	39.0	14.5
July	12.4	38.0	19.8	8.8	39.0	15.5
August	10.7	37.0	17.0			
September	11.0	37.0	15.6			
October	11.0	38.0	15.2			
November	11.0	38.0	16.1			
December	11.0	38.0	14.2			

* There were 325 million chicks produced in Georgia in 1959 and 2.4 billion produced in the United States.

Source: Agricultural Marketing Service, U.S. Department of Agriculture, *Agricultural Prices* (monthly, 1958–59).

Petroleum Supply Company[*]

On December 20, 1958, the Petroleum Supply Company, with headquarters in Houston, Texas, mailed out its usual Christmas bonus checks to all of its more than 400 employees. This bonus averaged a week's salary for each employee and totaled something in excess of $40,000.

When the financial statements for the month were reviewed by the chairman of the board, who was also the majority stockholder, he spotted immediately this annual disbursement figure classified as "Bonus." He had never liked the idea of paying a Christmas bonus. It was not that he had any basic objection to paying a bonus to his employees, but he had an ingrained philosophy about a bonus. He felt that so long as it was an outright gift with no implications of reward for superior performance, it not only was not appreciated by the employees who received it, but it was costly to the company with no reciprocating benefits. He decided to do something about it.

He called in the president and general manager of the company and made known his views. In fact, he said that he would no longer authorize the payment of employees' bonuses until the management presented to him a plan which would embody the following essential elements:

1. It would reward performance which resulted in improving the company's profit position and would provide an incentive to employees to achieve this goal.
2. It would not be paid to everyone. First, the plan would extend only to those employees whose positions were such that they could affect substantially the company's profit position. Among this group of employees the plan would have to provide that in order to receive a bonus one must earn it. This meant that some would receive a bonus and some would not.
3. The formula for figuring the bonus must provide for an amount large enough to furnish an incentive for superior performance; no niggardly amounts would be paid.
4. The amount to be disbursed should be roughly the same as in previous years; but because of the rearrangement in distribution, the amounts received by individuals who qualified would be substantially increased.

The chairman reviewed with the president the sales and profit figures for the year just completed and compared them with previous years. He stated frankly that the profit figures for the past year had been disappointing. Here are some of the facts which were reviewed in this session between the chairman and the president.

1. Of more than 40 retail outlets, over 20 percent had sales amounting to less than the breakeven point.

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[*] Prepared by E. L. Swearingen, Oklahoma State University.

2. The assets of the company totaled something more than $14,000,000, of which about $5,000,000 was invested in inventory, $8,000,000 in receivables, and $1,000,000 in fixed assets, including over $300,000 in autos and trucks.
3. The company's sales for the year just passed had declined somewhat from the previous year's total volume of almost $50,000,000. But, at the same time, operating expenses had continued to rise steadily.
4. A net profit (before taxes) of only $1,600,000 in 1957 had produced a return on investment of a little under 11 percent, which was considered less than satisfactory. The situation had worsened in 1958.

The chairman made known to the president that he wanted this situation improved, and it was his belief that a well-administered incentive bonus plan could be an important aid in improvement.

Needless to say, the president was concerned over the chairman's straightforward mandate; nor did he doubt that the chairman had meant every word he said. Implementing a plan to meet the chairman's specifications would not be without its problems.

In the first place, how would he advise his employees that the Christmas bonus, which they had come to look upon as a right, was to be discontinued, without creating a serious morale problem? Next, how was he going to originate a plan that would produce tangible, measurable results?

When he returned to his office, he called a staff meeting of the company's principal officers; and they talked over the assignment which lay before them. There was some sentiment in the group for seeking the services of an outside management consultant on the problem, but the consensus was that at least a first effort should be made with the talent at hand, thus saving the consultant's fee and perhaps discovering a formula better adapted to this company's needs than would be possible for an "outsider" to devise.

And so it was that the president appointed a committee to devise a draft of a bonus plan. This committee included the comptroller, who was to serve as chairman; the general sales manager; and the director of purchases. The first problem they tackled was identification of the areas of operation where improvement would have a direct bearing on the return on investment percentage to which the chairman had obviously attached considerable significance. These areas were not hard to identify. They were broken down into three general categories:

1. Sales and/or gross profit ratios.
2. Purchasing.
3. Management of the company's assets and employees.

After identifying these categories, the next step to be considered was how to identify an individual employee's contribution to, or responsibility for, improved performance in these areas. The sales manager foresaw great difficulties in identifying improved sales volume with an individual salesman, principally because of the nature of the supply industry. He made three points:

1. Many of the company's best customers placed their orders with the company because of financial ties through credit.
2. Personal friendships existed between the top officers of some companies which were good customers and the top officers of Petroleum Supply Company.
3. Many of the major customers apportioned their business among suppliers in an area.

All of these conditions made it relatively unimportant which salesman called upon and serviced the account. The volume of business from these customers would remain virtually unchanged, without regard to the salesmen's efforts.

The sales manager recognized a further problem. In the supply industry, it is customary for a field salesman to call upon and service the tool pusher or drilling superintendent at a field location; but when orders are placed, they are placed at a remote city which happens to be the headquarters location of the customer involved. The city salesman is sure to feel that his receipt of this order is a reward for the service he has rendered the purchasing department of the customer; whereas the field salesman is equally sure that except for his superb service and efforts with the field staff of the customer, the order would never have been placed. The sales manager believed that to have the various salesmen in competition with each other to receive credit for orders would result in detriment rather than gain to the company's overall sales effort.

In other words, the general sales manager was pretty much at a loss to know how it would be possible to measure individual performance as a basis for the payment of an incentive bonus.

The director of purchases also foresaw problems in attempting to recognize and reward individual buyers. Without developing all of his reasons, they can be summarized by stating that the discounts obtained on an order are related to factors over which the buyer has so little control as not to be a valid basis for a bonus award.

The comptroller viewed as somewhat easier the task of identifying and measuring performance within the area of management of the company's assets and its employees. He pointed out that the overwhelming preponderance of the company's assets were concentrated in inventory and receivables and that good management of either one of these assets involved maximum turnover and minimum loss, both of which were easy to identify through accounting records. Expense control also is a direct result of good management of employees; and since the greatest items of company expense, other than payroll, were the operation of the company's fleet of automobiles and trucks, long-distance telephone expense, and entertainment and travel expense, improvement in any of these areas would be easy to measure from accounting records. By the same token, the gross income at any given field store in relation to the expenses incurred furnished a "natural" for measuring improvement. It would be easy to identify exactly the investment at any field store, including, of course, investment inventory, receivables, cash, and fixed assets. Taking the lead furnished by the chairman, the comptroller believed that the return on investment should be measured at the stores, where income had to be generated. He believed that the managers of the stores, in the final analysis, held the key to improved management of assets and people necessary for a better return on investment. He also believed that store managers had been largely sales-oriented and had never really given much consideration to the idea that they had capital invested or entrusted to their custody upon which a satisfactory rate of return has to be earned. They, therefore, constituted an ideal target for an incentive program for better management.

Most of the managers of the stores had a high school education or less; and since the accounting work was all performed in the headquarters office, the managers of these stores understood very little of the relationship between their performance and the return on investment at their stores. It was the comptroller's view that a concentrated management training program for store managers, supplemented by a bonus plan, would make them conscious of the necessity of increasing profits through better management and would furnish them the incentive to put better practices into effect.

Of course the comptroller recognized that there were obstacles which had to be met, such as identifying sales allocated to a store because of delivery into its territory even though the store really could lay no claim for credit. The biggest single item involved was oil country tubular goods (pipe), principally because pipe historically had been in short supply and had been distributed to customers on an allocated basis, rather than in response to any supreme sales effort.

When the committee reported back to the president, it was the consensus that the comptroller should be commissioned to author a bonus plan embodying the elements which he thought would satisfy the chairman's mandate.

Shortly thereafter, the comptroller submitted to the president the bonus plan shown in the Appendix.

The president looked over the plan quickly and observed that it was drawn to include only store managers and district managers. He said, "You can bet your bottom dollar that the salesmen on the road aren't going to be happy when they hear about a bonus plan for store managers. What does the general sales manager have to say about the proposed plan?"

The general sales manager had had his say all right, and in brief he did not think well of it. His views can be described quite briefly:

1. The plan was discriminatory against salesmen.
2. The plan tended to overemphasize the importance of the management function at store locations, whereas the really important key to improved performance lay in increased sales volume.
3. Any bonus paid purely on application of a formula based upon accounting records would result in some inequities, that is:
   a) Payments to those who did not deserve them.
   b) Failure to pay some who were deserving, without regard to what the figures showed.

In spite of the misgivings of the general sales manager, the draft of the plan was submitted to the chairman, who approved it; and it was put into effect.

One final obstacle had to be overcome before the matter could be considered concluded; namely, how to announce to the personnel that their Christmas bonus would be discontinued and that in its place a limited bonus plan, open only to managers, would be substituted. A gratuitous circumstance contributed very substantially to the solution of this potentially serious problem. A wage survey conducted by the office of personnel had disclosed that the Petroleum Supply Company had not kept pace with the industry in its basic salaries and that an adjustment was needed to correct this condition, whereupon an overall wage increase was authorized and placed in effect.

The announcement of the discontinuance of the Christmas bonus was made to coincide with the announcement of the overall wage increase, which was slightly in excess of the Christmas bonus. It was therefore possible to announce that in lieu of the Christmas bonus an amount in excess of this was now being added to their regular compensation.

APPENDIX

PETROLEUM SUPPLY COMPANY
First National Bank Building
Dallas, Texas

February 25, 1959

A BONUS PLAN FOR STORE MANAGERS AND DISTRICT MANAGERS TO PROVIDE AN INCENTIVE FOR BETTER MANAGEMENT

I. *General Statement of Plan.* This bonus plan is designed to provide Store and District Managers with an opportunity to earn additional compensation for improved performance as reflected by an increased return on the company's investment at the stores under their management.

II. *Prerequisites of the Plan.* In order for the plan to work fairly, both to the company and to the managers involved, it is necessary that the manager at each location:
   A. Be given sufficient authority over the management of his assets, personnel, and the sales program within his assigned territory to give him substantial control over his performance.

B. Be charged with accountability and responsibility for the performance of his store or stores.

C. Be furnished with adequate yardsticks to measure his performance, and that the information used to measure performance be based upon highly accurate reports of achievement.

III. *Definition of Terms.* In order to understand the basis of this bonus plan and the factors which will determine bonuses paid, it is necessary that there be a common understanding of the definitions of certain terms that will be used throughout the statement of the plan. The following definitions are to be applied to the terms wherever they are used:

A. *Investment.* Investment at each location will include the annual average of the following:

1. Cost of month-end inventory maintained at the store, excluding:
   - *a*) Casing, tubing, and drill pipe.
   - *b*) Used machinery which the Machinery Department determines should be charged against the General Office inventory acount.
   - *c*) Central stocks placed at a given location at the direction of the Purchasing Department.
2. Investment in automobiles and trucks assigned to the location.
3. Investment in furniture and fixtures (including shelving, air conditioners, typewriters, counters, desks, chairs, file cases, adding machines, etc.).
4. Amounts invested in receivables growing out of bonusable sales credited to the location.
5. The funds maintained in agents' bank account at each location.

Note: Company-owned real estate, such as store buildings, lots, etc., are not classified as an "investment." Rental will be charged for the use of these facilities and will be included in the monthly store expenses.

B. *Bonusable Sales.* Bonusable sales are those for which a manager will receive credit in computing his bonus. They will include the following:

1. Allocated direct sales of machinery, supplies, and aluminum, plastic, and line pipe, except those sales which result exclusively from the activities of General Office or Sales Office personnel.
2. Stock shipments out of a store's inventory, except casing, tubing, and drill pipe.
3. Allocated sales accomplished through emergency order buyouts.

The omission of casing, tubing, and drill pipe from bonusable sales requires further comment. It is felt that in today's market no appreciable efforts or expense on the part of store personnel are required to sell casing, tubing, and drill pipe. All available pipe of this type could be easily disposed of through the General Office by allocation to a few customers. On the other hand, such pipe allocated to a store, either by way of direct sales, or to its inventory, constitutes a lead item which, properly used, can be a device for generating sales of supplies and equipment which are classified as bonusable sales.

It will be noted in this regard that the cost of casing, tubing, and drill pipe in a store's inventory is not to be charged as an investment at the store when computing return on investment.

It is also to be noted that the exclusion of casing, tubing, and drill pipe from the bonusable sales and investment is based upon today's market conditions. This determination is subject to change at any time, if and when conditions change, so that the sale of casing, tubing, and drill pipe becomes competitive and the market changes from a seller's to a buyer's market.

It should further be noted that aluminum pipe, plastic pipe, and line pipe are not excluded from bonusable sales.

A word of explanation also appears in order as to why stock shipments are identified as bonusable sales rather than allocated stock sales. The theory on which this decision is reached is that a store which maintains an inventory and has the cost of such inventory included in the investment upon which it must make a profit return in order to enjoy a bonus, is the store whose management has foreseen the requirements for the material and has stocked its inventory to meet such requirements, even though it may be sold by another store in another location.

C. *Bonusable Gross Profit.* Bonusable gross profit is the balance remaining after deducting cost of sales from bonusable sales.

D. *Bonusable Net Profit.* The bonusable net profit is the profit left after subtracting expenses from bonusable gross profit.

E. *Expenses.* Expenses are those operating costs in addition to cost of sales which will be deducted from bonusable gross profit determining bonusable net profit. Such expenses shall include:

1. Regular monthly direct store expense.
2. The pro rata share of total District Office expense.

   The pro rata share of total district expense of the District Office, divided by the number of stores in the district.
3. Cost of routine General Office services which apply to bonusable sales.

   Every sale involves certain direct expenses over and above those incurred at a store or district arising out of the fact that certain routine services necessary to consummate the sale are performed at the General Office. If these services were not rendered on a centralized basis in the General Office where they can be handled more economically by the use of skilled specialists and modern machines and equipment, they would have to be performed individually at each store point.

   Examples of the routine services referred to are as follows:

   a) Processing of orders, including pricing, costing, invoicing, recording, collection, and maintenance of customers' acounts.
   b) Purchasing of materials for inventory and direct shipments.
   c) Maintaining and servicing accounts payable.
   d) Credit investigations and issuing lines of credit.
4. Actual cost of special General Office services.

   This includes:

   a) Making quotations at managers' request.
   b) Repossession or special collection efforts involving employment of a collection agency or prosecution of a claim in the courts.
   c) Sales assistance. Special assistance from the General Office staff is available upon request to complete a sale. Most often this applies to the sale of a rig or other heavy machinery. For example, when a store determines that a customer

within its territory is in the market for the purchase of a rig or other heavy machinery items, such sales can ofttimes be expedited by calling upon the Machinery Sales Division to furnish a machinery specialist to appraise machinery or to work out the details of sales and terms of payment. The services of such specialists are available to a store, but their services require incurring expenses of travel, entertainment, communications, and the time of personnel. The expenses incurred will be charged directly against the store on an actual cost basis, whether the sale for which the services were requested is consummated or not. Money is wasted each year within the company by requesting such services when the opportunity for consummating the sale is extremely remote. A Store or District Manager must share in the responsibility for incurring such expenses and share in the risk that is involved in incurring needless expense.

5. Operating losses incurred as a result of the following will be charged directly against the responsible store as an expense when determination is made by the Bonus Committee that the loss resulted from negligence, bad judgment, or failure to adhere to prescribed company policy or procedure by store personnel:
   - *a*) Inventory shortages.
   - *b*) Loss of or cost of repairs to damaged property.
   - *c*) Loss on sale of assets.
   - *d*) Bad debt losses.

F. *Return on Investment.* Return on investment at any given location may be computed in terms of percentage by dividing the total of all investment items (A above) into the bonusable net profit (D above).

G. *Bonus Committee.* The Bonus Committee is a committee of three company executives appointed by the General Manager to review facts and circumstances of any questions arising out of administration of the Bonus Plan which are not specifically covered in this statement of the plan and to render decisions which will resolve such questions.

IV. *What is considered a satisfactory return on investment?* There are several factors which must be considered in determining what is a satisfactory return on investment at a given location. Obviously, if an investment does not yield a return which is comparable to the return that would be realized if the same amount of money were invested in savings accounts, government bonds, or gilt-edge stocks, such return cannot be viewed as satisfactory. In fact, an investment in such items as inventory, receivables, and capital equipment (furniture, fixtures, and automobiles) involves a risk of loss which is not present if the same amount of money were invested in savings accounts, stocks, or bonds. The return from such risk investments, therefore, must exceed that which could be earned from nonrisk investments in order adequately to compensate the investor for the risks involved. If it does not do so, it cannot be considered a satisfactory return.

Another factor which has to be taken into consideration in determining whether the return on investment at a given location is satisfactory from a management point of view is whether the business and profit potential at the specific location is being adequately exploited.

Recognizing the variable factors which enter into a determination whether return on investment at a given location is satisfactory, and in the absence of a better basis of measurement, it has been concluded that the most satisfactory starting measure of adequate return on investment is the average return realized by all stores from bonusable sales during the year 1958. This average was 10.5 per cent.

V. *Earning a Bonus.* The purpose of this bonus plan is to create an incentive for managers to improve the return on the company's investment at the stores under the management of the respective Store Managers and District Managers. It would be highly desirable to outline at this point a specific formula which would permit a manager to know in advance the exact amount of bonus that he would be able to earn if he achieved certain specific improvements in his operation. Unfortunately, it has not been possible to reconstruct information on past performance at the various store locations which would permit a completely accurate measure of past performance in those areas of management which are held to be subject to improvement. In order to establish such a measure with the degree of accuracy which is believed to be necessary, it is going to be essential that additional information be recorded over a period of at least one year. Until this period has elapsed and the necessary information can be compiled, it is not believed that a completely acceptable basis for judging improvement can be determined.

In lieu of a precise formula for computing a bonus based on improvement, the entire matter of awarding a bonus to District and Store Managers for the year 1959 is going to be left in the hands of a Bonus Committee appointed by the General Manager. At the end of the current year, this committee will review the achievements of each store and will make an independent determination of whether a bonus shall be awarded to the Store Manager and responsible District Manager. This committee admittedly will not be able to arrive at a conclusion as to the achievement at each store on a basis of mathematical certainty. It will, however, take into account all known factors of measurement and will make its determinations of bonus awards based on their best judgment of improved return on investment in 1959 over the 1958 performance.

While it is not possible to provide a formula at this time which will permit a computation in advance of what bonuses will be awarded, it is possible to state at this time the general basis upon which bonus award determinations will be made. This general basis will be as follows:

A. *Bonus will be based on improved return on investment in 1959 over 1958.* Since the 1958 company-wide average return on investment from bonusable sales is being accepted as "satisfactory," it follows that there will be a number of stores and districts whose return on investment during the year 1958 has been less than average. There will also be a number of stores and districts whose return for the year 1958 was better than average. Since the whole basis of this bonus plan is to provide an incentive for every manager to improve his performance, bonus awards will be made to managers for improvement over 1958 performance, whether this performance was above or below average.

B. *A reward for holding your own.* There will undoubtedly be cases in which a store achieves a return on investment in 1959 which is the same that it was in 1958. In such cases, recognition will be given for holding your own by the awarding of a bonus. It is probable, however, that the bonus awarded under these circumstances will not be as generous as that which is made to those managers whose stores have shown an increased return on investment. It is also probable that the award made to a manager whose store earned a satisfactory or better return on investment in 1958 and held his own in 1959 will be more generous than that to the manager whose return in 1958 was less than satisfactory and who held his own in 1959.

C. *A premium for achieving a satisfactory return.* It is probable that the manager of a store which earned less than a satisfactory return on investment in 1958 but was able to improve his return on investment in 1959 to a point which reached or exceeded the company-wide average will receive special consideration in the form of a premium bonus over and above that which would have been earned solely on the basis of improvement from previous year's performance.

D. *Some will earn no bonus.* It probably is inevitable that there will be those stores whose 1959 performance measured in terms of return on investment will not be as good as their 1958 performance. At those stores where the 1958 performance was less than satisfactory and the 1959 performance got worse, it is highly probable that no bonuses will be paid to the managers of such stores.

In those cases where even though the 1959 performance was not as good as 1958, but the return on investment in 1959 is still considered satisfactory, there will be a bonus awarded to the Store Manager involved, although the amounts will be less than those awarded to managers who held their own or showed improvement.

VI. *Computing Bonuses for District Managers.* A District Manager's bonus will be determined by the return on total investment in the district from all bonusable net profit earned by the stores in his district. In general, the same considerations will be given in determining the bonus awards to be made to District Managers as have been outlined above, except that the performance of all stores in the district will be taken into account in measuring the District Manager's achievements.

VII. *What will be the amounts of bonus awards?* It is not possible at this time to state with any degree of certainty the exact amount of bonus awards which will be made for the various levels of performance which have been outlined above as the basis for bonus awards. This is true because, first, the amount which will be available for distribution as bonuses will be directly related to the profit which is earned by the company for the year 1959 and, second, because it is going to be necessary to have at least one year's experience in determining the profits which will be generated by improved performance which justifies bonus awards and the distribution of bonus funds available. Until such experience has been acquired, it is going to be necessary to call upon managers to rely upon the fairness of the Bonus Committee and its expressed intention to reward as generously as possible those employees whose management efforts and profit results have contributed the most to the company's profit position. About the only guide that can be given at this time as to the amount of the bonus awards which is in the minds of the Bonus Committee is that it is believed that a minimum bonus of $300 should be awarded in those cases where a bonus is believed to have been earned and that for superior performance it is hoped that bonuses may reach a high that will approximate 10 per cent of the manager's annual salary.

VIII. *Reporting Performance.* A special report will be submitted each month to each Store Manager and District Manager covering the performance of the stores under his jurisdiction. This report will include:

A. A statement of the investment at each store. This will be supported by a schedule showing the items which go to make up the investment.
B. The bonusable sales and bonusable gross profit.
C. The store expense. This statement will be supported by schedule of the itemized expenses which go to make up the total.
D. The net bonusable profit.
E. The percentage of return on investment.

This report will show each current month's performance and will show year to date accumulative figures. The report will also reflect the year to date return on investment for the like period in 1958 so that it will be easy for each manager to ascertain how his current performance is comparing with the 1958 record which he is attempting to improve.

This Report of Return on Investment will be in addition to the regular monthly status report on sales, expenses, and profit and the monthly store inventory report which has been regularly furnished to the Store Managers and District Managers in past years. It is anticipated that the Report of Return on Investment will reach stores approximately three weeks after the close of the month covered by the report.

IX. *Payment of the Bonus.* Bonuses will be computed and paid based on the return on investment for a full year of operation. The bonus will be computed as soon as possible after the close of the year after all year-end adjustments have been taken into account and checks will be issued in a lump sum, paying a total bonus earned as soon after the close of the year's business as accurate computations can be made.

A. *Managers Terminated before End of Bonus Year.* In order for a manager to receive a bonus, he must be working in his position as manager at the close of the year (December 31). If a manager is terminated from his position, either voluntarily or involuntarily, prior to December 31, he will not receive any bonus.

B. *Bonus to New Managers.* No bonus will be paid to any new manager with less than six months' service on the job. This means that any manager appointed to his position after June 30 of a current year will not be eligible to earn a bonus from his operations during that year. For a new manager who has been in his position for six months or more, but less than one year, he will receive a pro rata share of what the annual bonus would have been had he been on the job for a full year.

C. *Managers at Newly Opened Stores.* The earning record of a new store will not become a standard until it has completed one full calendar year's operation. This means that the Store Manager at a new store location will not become eligible to participate in all aspects of this bonus plan until the store has been in operation at least one full calendar year. It is recognized, of course, that this may mean that the store has to be in operation as much as one year and eleven months before it has established an earning record which will qualify its manager to participate under this bonus plan —assuming that such a store opened in February of a given year and had to operate 23 months before it completed one full calendar year.

In order to furnish a desired incentive for good performance for a Store Manager who assumes responsibility for a new store, the General Manager may award a bonus which in his judgment represents equitable financial reward to the Store Manager for the performance he has rendered. Basically these determinations will be made from the earning record of the new store in relation to its investment, but other factors may also receive consideration, including the known business potential in the area and any hardship factors which have confronted the new manager.

D. *Revision of Geographical Area Allocated to a Store.* From time to time it may be to the company's best interest to revise the geographical area allocated a store to service. This may become necessary when opening new stores or closing old stores. When this occurs, an individual analysis must be made, and the Bonus Committee determines if a change in the base return on investment ratio should be made.

E. *Transfers of Managers from One Location to Another.* From time to time it may be in the company's best interest to request a competent manager to accept a transfer from an area in which he has demonstrated good qualities of management and for which he has been earning a bonus payment. Such transfers may involve movement into either a new territory or into a territory which is felt to have a good business potential but which has not had a history of earning a satisfactory return on investment.

In such cases it is obvious that the manager requested to accept the transfer would probably be forfeiting a probable earned bonus in his old territory, with no immediate prospects of improving his situation in the new territory. In such cases the General Manager may enter into a special arrangement with the transferring manager to guarantee a minimum bonus payment for a specified period until such time as the employee has had an opportunity to bring about required changes at his new assignment and to place himself in a competitive position for earning a bonus once again.

X. *Bonus Committee to Serve as Arbiter.* Insofar as it is possible to do so, all questions relating to the bonus have been covered by the plan outlined herein and decisions relating to the administration of the bonus plan will be based on the rules herein set forth. It is recognized, however, that from time to time situations will arise which have not been contemplated in advance and provided for in the original statement of the plan. Questions of administration presented by such situations will be reviewed and resolved by the Bonus Committee.

A. *Amendment of the Plan.* From time to time it may become necessary to amend certain phases of the present bonus plan, including adjustment as to what constitutes a satisfactory return on investment. All such modifications and changes will be reviewed and passed on by the Bonus Committee. The management reserves the right to amend, modify, or change the current bonus plan at any time, including the total discontinuance of the plan, subject to one firm commitment, however, that is, that no changes will be made during an operating year which will affect the return on investment which will be considered satisfactory for that year or any change in the increments of reward that will be awarded for improved performance over the standard which was set forth at the beginning of the year.

B. *Appeals to Bonus Committee.* Any manager who takes issue with any finding of fact or interpretation of the plan by those who are charged with the day-to-day routine administration of it is at liberty to make an appeal in writing to the Bonus Committee for a review of the controversial decision which has been made. The employee in such cases will receive a direct reply from the Chairman of the Bonus Committee stating the committee's findings and decision on the question appealed.

The Georgia Marble Company (A)[*]

The Georgia Marble Company was established in 1884 to extract the marble from the Long Swamp Valley, near Tate, in North Georgia. Probably, out-croppings of this deposit had been first worked by the Indians. Recent excavations in the Etowah Mounds yielded figures made of marble which had similar characteristics.

The first known white artisan to extract and to fabricate material from this area had begun working it about 1835. The lack of adequate transportation facilities had retarded the industrial development, however, since the first customers had to be within a radius of ox cart delivery. In a deposit of Dolomitic limestone in an adjacent area, a waterwheel had been set up as a source of power for use in the fabrication of stone. However, the work produced had been crude and, by the year, 1884, this operation had terminated.

Upon this earlier background of the area, some additional events happened during the Civil War period which had a definite influence on the area and culminated in the establishment of The Georgia Marble Company. On a visit to the region as a member of "Morgan's Raiders," a Yankee military group in the Civil War, O. F. Bane observed the existence of a marble deposit. Another influential factor was the construction of the Marietta and North Georgia Railroad (later Louisville and Nashville Railroad) to Tate Station in the early 1880's. Then, too, there was a chance meeting on the train of Frank H. Siddall, a Philadelphia soap millionaire, and the brother-in-law of Oscar Bane, H. C. Clement, who was also a cousin of Percival Clement, active in Vermont marble. Quite by chance, the conversation drifted to the North Georgia marble quarries. A friend of Siddall, Mr. Dewar, had already made a trip to the area to survey the situation as to feasibility of investment. In this chance meeting and conversation, the inception of the firm had its roots.

Those present at the organization meeting were: Henry C. Clement, Frank H. Siddall, Charles Willoughby, Harry Dewar, and Oscar F. Bane. Mr. Siddall was elected temporary president and Mr. Bane, temporary secretary. (See Exhibits 1 and 2.)

H. C. Clement became the firm's first president. He was associated with the Banes in the wholesale clothing business in Chicago. With him to guide the new company were Frank H. Siddall, vice-president, Levi Bane, secretary, and J. A. Dewar, general manager. O. F. Bane replaced Levi in 1885 as secretary.

The corporation, about 1884, arranged a mineral lease on a section of marble properties belonging to members of the Tate family, in whose possession this part of the property had been since 1835. The lease was on a royalty basis for 25 years with an option for renewal.

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[*] Prepared by Curtis E. Tate, University of Georgia.

There was limited quarrying activity during the first year. Time was devoted, primarily, to the procurement of machinery, the removal of overburden, construction, setting in place of equipment, and additional capital procurement. Equipment and operational procedures were copied from the Vermont Marble operation, with some supervisory personnel imported from Vermont. During this period the board of directors met frequently, discussing and taking action on operations and problems of finance and activities. The corporate minutes indicate action and consideration by the entire group, with no one person playing a dominant role.

EXHIBIT 1

Initial Stock Subscription List*
May, 1884

Subscriber	*Number of Shares Held*
Henry C. Clement	150
Oscar F. Bane	150
Charles L. Willoughby	50
David K. Hill	50
Levi B. Bane	50
Nathan L. Clement	50
Frank H. Siddall	250
C. M. Smith	83
Harry Dewar	162
J. A. Dewar	5

* Common stock with $100 par value; initial capitalization of $100,000.

EXHIBIT 2

Stockholders after Increase of Capitalization to One Million Dollars
July, 1884

Subscriber	*Number of Shares Held**
Frank H. Siddall	2500
Henry C. Clement	1500
Harry Dewar	1620
David K. Hill	500
Levi B. Bane	500
J. A. Dewar	50
C. M. Smith	830
Oscar F. Bane	1500
Nathan L. Clement	500
Charles L. Willoughby	500

* Par value $100 per share.

It was during the second year of operation that the decision was reached to procure the Kennesaw quarrying properties, and to establish a second operation there. In this decision it was understood that the Tate operation would continue to be the company's principal one.

During the years that followed, the company was moderately profitable to unprofitable, in terms of the accounting practice of the period.[1] Frequently disappointing results were encountered because of unanticipated difficulties in the quarrying operation. Poor quality sections of stone were found. It was not unusual for the company to be unable to supply all of the stone needed, either because of inadequate quantities produced or because of scarcity of grade. This was true, particularly, of the number 1 grade.

The primary objective of the company was to quarry, saw, and semifinish the marble. It soon became apparent that there was an opportunity for the establishment of independent finishing works. The Harrisons, McGraths, Keelers, Andersons, Sickelses, Bradys, Dewars, Norcrosses, and others, set up finishing plants in Marble Hill, Tate, Nelson, Ball Ground, Canton, and Marietta—all towns nearby.

The labor force of The Georgia Marble Company was paid off in scrip, by way of a side agreement between The Company and the Tates who operated a store in Tate, Georgia. The scrip was redeemable in merchandise and cash at the store, the operation of which was bid on a five-year basis between the Tate brothers, William and Stephen C. The first reference to any of the Tate family as stockholders was shown at the stockholders' meeting of 1888, when Stephen C. Tate had 377 shares voted by proxy. In the meeting of the next year, Stephen voted by proxy 300 shares and William, 100 shares by proxy. This stockholder relationship continued past the death of both of these men some years later. By 1900, two members of the family were serving on the board of directors.

Additional funds were provided along the way from the sale of bonds, preferred stock, and, on occasion, by notes given to some of the major shareholders. The bonds were 6 percent, but sold at 0.75+.

In an effort to obtain more profitable business during the 1890's, the company procured the necessary equipment and personnel to finish and to set stone, both interior and exterior. Some Italian labor was imported to fill the labor requirements. After a contractual agreement was signed for the Montgomery-Ward Building in Chicago, the company was advised that it would not be permitted to use its nonunion craftsmen to set the stone. Following some negotiations, however, an accord was reached that permitted the use of the company's own labor, provided it paid the higher scale of the unionized stonesetters of Chicago. After this unfortunate experience, the company returned to the firm's original objective of quarrying, sawing, and semifinishing marble.

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[1] No provision was made for depreciation. All items were carried on the books at cost.

By 1887 stockholder distribution had increased. It continued to increase. But, in spite of its projected potential, the company had not had performance such as to attract capital with ease, in an adequate amount to satisfy the insatiable appetite of establishing a new extractive company working mineral deposits in a virgin territory. Records show that, for a period of some months, a Mr. Abbott held an option to purchase the company. It was never exercised.

A motion was tendered by Stephen C. Tate and accepted at the annual stockholders' meeting in May, 1900, that the directors seek a buyer for the assets of the corporation, the reason being that there was needed a larger amount of capital to operate successfully in exploiting the deposits. The corporation had been under almost constant pressure since its establishment to raise additional funds. The need for employee housing, more equipment, better equipment, different equipment, the need to open new quarries, seems to have ever "dogged" the steps of the management. (See Exhibit 3.)

During the period from 1895 to 1905, Stephen C. Tate and his subsequent estate held the store operation contract. (This was the store where company payroll was redeemed.) It had been managed by his son Sam, a bachelor. "Col. Sam," as he was later known, had been thought of as something of a hell-raiser in his younger years[2] but had settled down to Puritanical sobriety with considerable business acumen at the time he had taken over the store management.

In 1905, the William Tate estate won the store contract. A later associate of Col. Sam commented, "Col. Sam was quite concerned over what should be his future endeavor."

It was at this point he was approached by Henry C. Clement, president of The Georgia Marble Company, about his taking over the management of the company. To assume this position it was apparently necessary for Sam to acquire a sizable block of stock. During the period in which efforts were being made to work the financial details, Col. Sam gave some consideration to relying on family resources. Some discussions were conducted with the appropriate members, two of whom were cousins. Previously, he had given financial assistance to R. T. Jones of Canton Cotton Mills to help him achieve a personal project objective in establishing the cotton mills. In the final negotiations, it was this man who came in with the needed financial assistance to consummate the transaction. Col. Sam, at 45, became president and general manager of the company in 1905 with the acquisition of 6,791 shares of stock. (See Exhibit 4.)

The immediate consequence of the change in management was a drive for more production by adding equipment, changing procedures, clearing

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[2] William Tate (ed.), *Documents and Memoirs, Genealogical Tables, The Tates of Pickens County* (Marietta, Ga.: Continental Book Company, 1953), p. 20.

EXHIBIT 3

The Georgia Marble Company (A)
Financial Statement of 1900
(Balance Sheet)

Assets

Real estate and leases	$1,576,289.80	
Cash	7,953.80	
Notes receivable	21,324.61	
Accounts receivable	40,712.22	
Stocks and securities	57,500.00	
Machinery and fixtures	246,164.94	
Railroads	78,132.75	
Buildings	30,050.00	
Marble (inventory)	116,391.07	
Supplies	7,477.38	
Total Assets		$2,181,996.57

Liabilities

Capital stock	$1,500,000.00	
Bonds	500,000.00	
Notes payable	13,950.00	
Accounts payable	108,285.21	
Profit and loss	59,761.36	
Total Liabilities		$2,181,996.57

Statement of Gains and Losses
(Income Statement)

Gains			
Sales	$ 132,260.05		
Less purchases	11.10	$ 132,248.95	
Rent		1,645.43	
Railroad earnings		5,813.11	
Increase in marble (inventory)		5,663.49	
		$ 145,370.98	
Losses			
Expense—Maintenance		$ 14,477.71	
Labor		47,180.94	
Salaries		12,700.00	
Freight		11,904.62	
Royalty		7,591.58	
Traveling		1,510.89	
Insurance		694.89	
Interest		34,442.88	
Discount		622.63	
			$ 131,126.14
Net Gains			$ 14,244.84

quarries, having the S. C. Tate estate construct additional tenant houses to make possible the procurement of additional labor. The results of the first year of the new management may be noted by examining the financial statement of 1906. (See Exhibit 5.)

During the second year under Col. Sam's management, items of equipment and machinery which no longer had a useful life but whose value on the books was equal to the original cost were charged off. The Panic

EXHIBIT 4

THE GEORGIA MARBLE COMPANY (A)
Financial Statement of 1905
(Balance Sheet)

ASSETS		
Real estate and leases	$1,748,639.80	
Cash	18,790.09	
Notes receivable	19,673.14	
Accounts receivable	49,026.83	
Stocks and securities	1,500.00	
Machinery and fixtures	265,487.50	
Railroads	89,739.85	
Buildings	31,066.00	
Marble (inventory)	108,099.76	
Supplies	7,512.68	
		$2,339,535.65

LIABILITIES		
Capital stock	$1,500,000.00	
Bonds	500,000.00	
Improvement notes	130,000.00	
Notes payable	1,785.39	
Accounts payable	65,590.08	
Profit and loss	142,160.18	
		$2,339,535.65

Statement of Gains and Losses
(Income Statement)

Gains		
Marble, as per inventory	$ 108,099.76	
Sales	206,066.34	$ 314,166.10
Inventory, April 30, 1904	91,326.54	
Purchases	258.25	91,584.79
Gains on marble and sales		222,581.31
Rents		1,675.55
Railroad earnings		9,600.02
Gross Profits		$ 233,856.88
Losses		
Expenses—Maintenance	$ 32,712.50	
Labor	56,490.13	
Salaries	8,700.00	
Freight	16,339.70	
Royalty	14,712.12	
Traveling	981.34	
Insurance	1,408.33	
Interest	39,518.97	
Discount	3,985.89	$ 174,848.98
Net Profit		$ 59,007.90

of 1907 brought a period of reduced sales for marble. As evidenced in the annual reports of the president-general manager given in 1908 and 1909, all employees were continued on the payroll and customer accounts were carried. In face of adversity the company continued to pay its short- and long-term obligations. It was evidence of a "gilt-edged" company

EXHIBIT 5

THE GEORGIA MARBLE COMPANY (A)
Financial Statement of 1906
(Balance Sheet)

ASSETS

Real estate and leases	$1,747,989.80	
Cash	44,210.43	
Notes receivable	46,725.77	
Accounts receivable	39,251.22	
Machinery and fixtures	272,860.50	
Railroads	91,966.90	
Buildings	31,566.00	
Marble (inventory)	115,679.05	
Supplies	9,832.68	$2,400,082.35

LIABILITIES

Capital stock	$1,500,000.00	
Bonds	500,000.00	
Improvement notes	130,000.00	
Accounts payable	8,246.49	
Profit and loss	261,835.86	$2,400,082.35

Statement of Gains and Losses
(Income Statement)

Gains		
Marble as per inventory	$ 115,679.05	
Sales	283,830.28	$ 399,509.33
Inventory, April 30, 1905	108,099.76	
Purchases	228.42	108,328.18
		291,181.15
Rents		1,826.25
Railroad earnings		11,588.39
Gross Profits		304,595.79
Losses		
Expenses—Maintenance	$ 29,034.32	
Labor	68,719.69	
Salaries	5,700.00	
Freight	18,702.90	
Royalty	17,735.66	
Traveling	1,088.18	
Insurance	1,298.26	
Interest	34,975.96	
Discount	7,019.85	$ 184,274.82
Net Profits		$ 120,320.97

in Col. Sam's opinion. Taking care of employees and customer needs in a period of such adversity brought much personal pride and satisfaction to him. Dean William Tate tells us in his memoirs:

> No man has more respect and reverence for women or more love for children; yet he has never married. It was a delicate subject, but I went straight at the heart of the big, serious man in an unguarded moment and he made a confession.
>
> "I have thought about marriage," he said, "but with it always comes the thought of the children here in these hills, hundreds of them, who need me; I

have thought that perhaps if I had children of my own I might neglect this greater number of other children."[3]

Justification for continued utilization of the total work force was the need to retain the men in order that future business commitments might be met most advantageously.

The year of 1909 saw the expiration of the initial 25-year lease of marble properties from the S. C. Tate and William Tate estates. Some of the executors of the William Tate estate saw an opportunity to dispose of their property by way of sale. After a period of impasse in negotiations (the initial lease contained an option of renewal clause) the terms of sale were agreed upon: $324,000 to be paid: $60,000 cash at once (1909), $20,000 per year 1910 through 1921, final payment of $24,000 to be made in 1922. The deed was to be held in escrow until the final payment was made. This transaction made The Georgia Marble Company joint owners with the Stephen C. Tate estate of certain marble properties.

At this point, the company was, to a great extent, dependent for sales volume on the local finishing plants. On occasion, joint contracts were undertaken, but, primarily, the activities of the finishers determined the sales of The Georgia Marble Company.

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[3] William Tate (ed.), *op. cit.*, p. 21.

The Georgia Marble Company (B)

The marketing activities of The Georgia Marble Company were confined primarily to the sale of cubic stock. Advertising promotion carried on by the company was directed toward this objective. Demand for the company's number 1 cubic stock was strong: "We have demand for every No. 1 block we can produce. . . ." There was a problem in marketing the number 2 and number 3 grade blocks, however. At this point the company was not carrying on any finishing activities. This, in effect, made its activities dependent on the whims of the finishing trade.

In a discussion of the utilization of funds procured from $1,500,000 in bonds issued in 1911, Col. Sam expressed the feelings he had had for some time.

> I have had it in mind for quite a while that the wisest and most profitable thing to be done for those interested in The Georgia Marble Company is that the Company control the manufacture of their product and I have therefore made provision in the new issue of bonds for $500,000.00 of same to remain in the Treasury to acquire additional property and I would recommend that if deals can be made whereby The Georgia Marble Co. can exchange these bonds at such price as necessary to acquire The Blue Ridge Marble Company, The Geo. B. Sickels Marble Co., The Kennesaw Marble Co. and The Georgia Marble Finishing Works plants, it be done. As it now stands, we are entirely dependent upon these finishers to market our product, and we find they often push the sales of such materials as they can find a ready sale for without any efforts to dispose of any surplus we may have and often times they demoralize the business, to some extent, by making unnecessarily low prices in order to get business. I believe the profits of The Georgia Marble Company, as well as all the finishers, could be increased not less than 25% by the consummation of a trade of this kind.[1]

None of the above-mentioned organizations owned or operated any quarries. They purchased their marble stock from The Georgia Marble Company. The company was showing a continued interest in keeping its assets directed toward the extraction and fabrication of stone.

From the beginning of the new management under Col. Sam in 1905, The Georgia Marble Company responded to the individual drive and personality of its president-general manager with improved profits and greater growth. (See Exhibit 1.) An age at which he desired retirement was soon reached by Mr. George B. Sickels. The stock of his company was acquired by Col. Sam Tate, Mr. H. L. Litchfield, corporate secretary, Walter Tate, vice-president and brother of Col. Sam, all of the company, and J. M. Eaton, a Marble Hill merchant.

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[1] President's Report, 1911. (The Georgia Marble Company. Official Record, No. 2, pp. 15–17.)

EXHIBIT 1

The Georgia Marble Company (B)
Financial Statement of 1912
(Balance Sheet)

Assets

Real estate and leases	$2,247,400.00	
Cash	31,464.67	
Notes receivable	1,681.53	
Accounts receivable	95,385.52	
Stocks and securities	49,000.00	
Machinery and fixtures	271,899.27	
Railroads	128.027.85	
Buildings	69,054.40	
Marble (inventory)	197,599.17	
Supplies	13,333.06	$3,104,845.47

Liabilities

Capital stock	$1,500,000.00	
Surplus	500,000.00	
Guarantee fund	50,000.00	
Profit and loss	347,693.28	
Real estate purchase notes	231,500.00	
Bonds	400,000.00	
Notes payable	51,200.00	
Accounts payable	23,091.19	
Dividend account	1,361.00	$3,104,845.47

Statement of Gains and Losses
(Income Statement)

Gains		
Marble as per inventory, April 30, 1912	$ 197,599.17	
Sales	337,921.32	$ 535,520.49
Marble as per inventory, April 30, 1911	167,863.79	
Purchases	198.48	168,062.27
Gains on marble		$ 367,458.22
Rents		4,106.58
Gross Profits		$ 371,564.80
Losses		
Expense, maintenance	$ 48,265.83	
Labor	95,319.59	
Salaries	17,200.08	
Freight	17,135.67	
Royalty	18,606.40	
Traveling	1,204.48	
Insurance	1,909.35	
Interest	35,232.93	
Discount	1,725.78	
Wm. Tate—Real estate purchase	3,395.47	$ 239,995.58
Less for depreciation		23,557.02
Net Profit		$ 108,012.20

The Blue Ridge Marble Company was purchased from the Harry Dewar estate and two or three minor stockholders, after an unsuccessful attempt by the widow and son to continue the operation of the firm. Most of the stock of this firm was purchased by Col. Sam and his brother-in-law, Alex Anderson. It continued as an independent operation under the direction of Anderson.

A gentlemen's agreement determining pricing policy made more pleasant the company dealings with The Kennesaw Company, principally owned by a Mr. Newell of Boston. It continued to operate independently.

Another operation, the Southern Marble Company, continued along independent lines with both quarrying and finishing facilities. Mr. O. W. Norcross, a contractor of Worcester, Massachusetts, owned this company.

Hampered somewhat by the general economic conditions, and later by World War I, The Georgia Marble Company continued to hold its own and made some advance. The years of 1916 and 1917 were important years in the history of the company. It was during this period that it acquired all of the adjacent independent finishing companies with the exception of The Georgia Marble Finishing Works of Canton, Georgia. (See Exhibit 2.) These acquisitions enabled the company to assume a more positive and directed course in achieving greater sales results. (See Exhibits 3 and 4.) Still another significant factor, when the dust had

EXHIBIT 2

SCHEDULE OF ACQUISITION OF FINISHING OPERATIONS

The Southern Marble Company	May, 1916
Amicalola Marble Company	October, 1916
The Kennesaw Marble Company	February, 1917
The Blue Ridge Marble Company	February, 1917
The George B. Sickels Marble Company	February, 1917

EXHIBIT 3

THE GEORGIA MARBLE COMPANY (B)
Statement of Gains and Losses for Year Ending
April 30, 1916

Marble as per inventory April 30, 1916	$239,206.57	
Sales for year	246,017.64	$485,224.21
Marble as per inventory April 30, 1915	$244,372.64	
Purchases of marble for year	218.06	$244,590.69
Gains on marble		$240,633.52
Rents		3,649.28
		$244,282.80

Losses

Expenses	$31,774.28	
Labor	76,165.39	
Salary	17,400.00	
Freight	13,662.48	
Royalty	14,941.07	
Traveling	1,046.30	
Insurance	2,912.05	
Interest	25,080.84	
Discount	5,751.31	
Wm. Tate purchase E. & E.	46.82	188,781.34
Net Profit		$ 55,501.46

EXHIBIT 4

The Georgia Marble Company (B)
Summary of Income and Profit and Loss, 1919

Sales		
Rough blocks	$ 118,520.96	
Monumental	1,107,095.57	
Interior	211,180.18	
Exterior	132,454.37	
Scrap and sundries	22,676.42	
	$1,591.927.50	
Less returns and allowances	41,567.37	
Net sales		$1,550,360.13
Cost of goods sold	$1,414.749.71	
Less inventory of marble		
Materials, and supplies, and so on, December 31, 1919	330,551.29	
Net cost of goods sold		$1,084,198.42
Gross profit from sales		$ 466,161.71
Selling expenses		40,157.63
Net profit on sales		$ 426,004.08
General expenses		77,329.70
Net profit on operations		$ 348,674.38
Other income		28,846.38
Gross income		377,520.76
Income charges		
Interest on bonds	$ 62,000.00	
Amortization of discount and expense on bonds	11,025.12	
Interest on notes payable	18,835.37	
Cash discounts on sales	24,435.51	
Interest on notes receivable discounted	254.03	$ 116,550.03
Net Income		$ 260,970,73

cleared, was that Col. Sam was then voting 13,112 shares of the 20,000 shares of outstanding stock.

The termination of the war came and the following key personalities were in officer positions, places that they were to fill, in most cases, for the next decade and a half or longer:

Col. Sam Tate, president
Alex Anderson, vice-president, manager of the Nelson Plant (Blue-Ridge Marble Company plant)
A. V. Cortelyou, vice-president, manager of the Kennesaw Plant
Harry Miles, vice-president, manager, New York Sales Office
Walter Tate, vice-president
H. L. Litchfield, vice-president
A. B. Bayless, general manager (The first time since Col. Sam became president that a separate general manager had existed.)
G. M. Atherton, secretary and treasurer, manager of Monumental Operations at Tate, Georgia

While conditions of the company somewhat followed the pattern of the business cycle, it prospered in the twenties. After Col. Sam's arrival in New York City in 1924 on a trip around the world, the board of directors voted that the company pay his expenses as a token of appreciation for his services and to give him opportunity for a much-needed rest to regain his health.[2] In an interview for a story in a national magazine of that year, Col. Sam was estimated to be worth 165 million dollars.[3] The marble deposits were estimated at that time to be "a solid mass, from five to seven miles long, one-half mile wide, and in some places estimated by geologists to be 2,000 feet deep."[4]

Certain policies followed during this period were to have a profound effect in the future on the company's operations. While the president was known to be very autocratic in his rule, a considerable amount of decentralization did exist. Vice-presidents in charge of individual operations were expected to follow the wishes of Col. Sam. While there was not as much "looking over the shoulder" as might have been expected, he, who had given up his quart a day and his pipe and cigar, was strongly opposed to the consumption of alcoholic beverages or tobacco. An officer now in the company jovially recalls that he was made to understand there would be no advance in grade or pay if Col. Sam ever caught one smoking. The result was a swallowing of cigarettes on six or seven occasions. From the point of view of some onlookers, it seemed that politics existed, too, in the upper echelons of the company, where favoritism might have been shown in the parceling out of orders.

There were other factors pertinent to the future course of history of the company. Some mausoleum work was done for which securities were taken instead of money. Certain officers of Georgia Marble, and others, made purchases without payment, either directly charging to the company or at one of the two company stores. Members of the Tate family, with others, became involved in the development of "Tate Mountain Estates," a mountain resort hotel and golf course, constructed in an inaccessible mountain area. And, Mr. Willie Anderson, brother of Alex, both of whom were formerly with Blue Ridge, became involved in the Tennessee Pink Marble Company, heading this operation.

Some 6,000 acres of land was purchased with the objective of developing a water power plant to supply the company's power needs. Two or more engineering surveys were conducted. A new steam power plant was constructed. But, at this point, a contract was made with the Georgia Power Company to supply power needs. The power plant was used very little and the land for the water power plant was later to be of value for its stand of timber. The farm depression adversely affected the sale of monuments in the rural South. And the increasing use of no-monument cemeteries in the North and Northeast began to be felt in the company.

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[2] In 1927, the board again voted a trip to renew his health, this time a cruise in the Mediterranean.

[3] Saunders, W. O., "He's King of Hearts in Georgia," *Collier's*, Vol. LXXIV, pp. 12–13, December 6, 1924.

[4] William Tate, *op. cit.*, p. 4.

But the late twenties and early thirties had their good days too. Among them were contracts for the New York Stock Exchange Building and a large number of new post offices and other public buildings. Dividends were paid through 1931.

During the year 1933 the company lost $225,000 on its operation, according to the report of the audit. While, in the early years of the depression, the company had successfully countered the trend, early in 1934 orders fell away. The Kennesaw Plant was closed early in 1934 and continued so except for one brief period. A member of the administrative group at Kennesaw at that time says, "I sat for six weeks with nothing to do." Seeing nothing in view, he quit to find other employment, and, when he tendered his resignation, was thanked by the manager for saving himself the pain of the termination.

Many projects were undertaken during the depression years to provide employment for the work force. Some were carried on at cost, or less: the road to the Tate Mountain Estate, the marble residence of Col. Sam and his unmarried sister, the $75,000 to $100,000 of marble given for use in the buildings at Wesleyan College in Macon, Georgia. And there were other such projects.

By September, 1934, in order to continue operations, even on a curtailed basis, Col. Sam had pledged 10,000 shares of his stock for loan from a group of Atlanta banks. Interests of the banks had to be represented and protected by the establishment of a position of executive vice-president. This officer was to be responsible for the business, operation, and sales of the corporation. Mr. E. W. Gottenstrater was elected as executive vice-president. Officers at this time were:

Col. Sam Tate, president
E. W. Gottenstrater, executive vice-president
Alex Anderson, vice-president
A. V. Cortelyou, vice-president
Harry H. Miles, vice-president in charge of New York Sales Office
Herbert L. Miles, vice-president in charge of Atlanta Office
H. L. Litchfield, vice-president
Walter E. Tate, vice-president and general manager

Gottenstrater's tenure of office lasted from September 26 to November 14 at which time he resigned. The banks (voting trustees) decided to permit Col. Sam to return to active management of the company.

During early 1935 a decision was reached to apply for a loan from Reconstruction Finance Corporation of $709,000. When RFC proposed a loan of only $500,000, the terms were unacceptable to Col. Sam and the application was withdrawn.

An effort was made to sell the company through the Robert R. Otis Company at a price of $3,000,000. Nothing came of this.

Again in 1936, the bank group asked that the office of executive vice-president be filled with a person of their choice, W. C. Cram. The comment made by an observer affiliated with the company was, "It took Col. Sam about a month to eat those fellows up. He began working on them as soon as they arrived and, by the end of the month, he had them eating out of his hand. He was just that kind of man—a strong, personable individual."

When illness struck Col. Sam in 1936, Mr. Cram continued to serve (though some questioned his effectiveness). In 1937, the Corporate Articles were amended and Col. Sam was elevated to chairman of the board. His brother-in-law, I. P. Morton, became president. In October, 1938, the curtain of an era closed as Col. Sam died.

Now the courts had their role to play, along with the heirs, the creditors, and the corporation. The organization continued to function, but was hampered by the haze of uncertainty and lack of strong leadership. The management, under court order to elect no directors until Col. Sam's estate was settled, left existing practices generally unmolested. One attempt was made to sell the stock held by the receivers at public cry, but the bid was inadequate in the eyes of the court. During a second public auction in April, 1941, the stock was purchased by a syndicate of individuals who joined together to form the Georgia Marble Holding Company. Immediate needs were a stockholders' meeting, election of directors, and taking steps to reorganize the corporate charter in keeping with the more recent revision of Georgia corporation laws.

The first stockholders' meeting found the Georgia Marble Holding Company in possession of 13,121½ shares of the 20,000 shares outstanding. The board of directors elected follow:

Alex Anderson
C. H. Candler, Jr.[5]
J. R. Cowan
Clement A. Evans[5]
Wilbur Glenn[5]
Granger Hansell[5]
H. L. Litchfield
I. P. Morton
James D. Robinson, Jr.[5]
L. E. Tate

Mr. Cowan was brought in by the new controlling group to be executive vice-president until he could be moved into the president's position.[6]

Here was an organization in which the operating procedures, the physical facilities, the personnel policies, the assets, had been permitted to deteriorate steadily since 1929. A portion of assets had been used for the personal benefit of some officers and employees, a part of which was covered by personal notes.

The value and continued utility of some assets carried on the balance sheet were questionable. The Marietta (Kennesaw) plant had been idle since 1934, with the exception of six months in operation in 1936. Taxes, insurance, building maintenance, watchman wages, salaries for the plant manager and his assistant, continued to run costs up. There was the power plant with its idle boiler and turbine. Parcels of real estate that were no longer useful were scattered here and there. Tenant houses for employees were in need of paint, repairs, and some lacked electric lighting. What should be done about the company's first mortgage 6 percent sinking fund gold bonds, amounting to $407,000 as of December 31, 1940?

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[5] Member of Georgia Marble Holding Company.

[6] An engineer by profession, he had served as coordinator on the building of the Mellon National Gallery of Art, Washington, D.C., followed by a period as president of the Ross-Republic Marble Company, Knoxville, Tennessee. At this time Ross-Republic was bankrupt, but its failure could not be attributed to Mr. Cowan's action as president. A controller with the company since 1927 makes this appraisal of Cowan, "An engineer first, a real good businessman, handy with a slide rule in analyzing statistical information."

There was the question of what should be done about the school facilities for the children of the area. It had long been the custom of the company to provide the physical facilities and the funds for faculty salaries. The Nelson store was having a monthly loss of $400. Also, there was a question of what to do about the Godfrey plant, its real property and improvements in Atlanta, the mausoleum accounts, Grand Rapids, Michigan, Oak Ridge Abbey Mausoleum, Chicago, and one in Enid, Oklahoma. These facilities had been constructed in the twenties and the company, in lieu of cash payment, had accepted claims against the respective assets.

What should be the status of property jointly owned by The Georgia Marble Company and the S. C. Tate Estate?

In dealing with the issues at hand, there were to be considered the economic consequences upon the community which would result from a drive on improved efficiency. While stringent action might, in theory, improve earnings, how would the company fare if these policies should cause a mass exodus of the workers and their families? The demands of the national defense effort were also taking ever-increasing gulps of manpower.

In the face of these conditions, what should be the policy of the company relating to sales, to personnel, to the community, toward operations, and toward its methods?

The Georgia Marble Company (C)

Under the control of the new ownership, an executive committee was established in The Georgia Marble Company to act for the board of directors between meetings of that body.[1] The board formulated the policy which the company should follow and a letter was issued by the president, Mr. Morton, interpreting the policy to the officers and employees.[2]

April 23, 1941

To Officers and Employees of The Georgia Marble Company:

I am very happy to announce to you that the period of uncertainty which has beset this company has at long last definitely ended. Colonel Tate's controlling interest in the company has passed into strong hands and the prospects are most promising.

A new Board of Directors was selected by the Stockholders on April 14. This Board has met and I have been re-elected President. Mr. J. R. Cowan, now of Knoxville, Tennessee, was chosen First Vice-President and General Manager. Mr. Litchfield was made Secretary. Other officers have been re-elected.

I want to quote from the Minutes of the Board of Directors showing their proceedings as follows:

A discussion of the future policy of the company then took place, after which it was moved, seconded and unanimously

Resolved:

1. That the Directors earnestly desire a continuance of the cordial relations that have always existed between the officers, stockholders, and employees.
2. That the Directors pledge themselves to use their best efforts to reestablish this company in the commanding position it is accustomed to occupy in the business and financial field, and request the officers and employees to cooperate to this end.
3. That the management aim at increasing the demand for and sales of marble as a means of taking up the slack in employment and absorbing the full time and talents of all officers and employees; to the end that loyal and efficient persons may be assured of steady work.
4. That all officers and employees are invited to make constructive suggestions as to new uses of marble, improvements in the method of quarrying or finishing, and ways in which the community life may be made more pleasant and the general welfare improved.

I believe that these resolutions are self-explanatory. I feel sure that they express the genuine sentiments of the Board and the Management.

Cordially,

President

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[1] Membership of this executive committee consisted of:

I. P. Morton	James D. Robinson, Jr.
J. R. Cowan	Wilbur Glenn
Clement A. Evans	

[2] Minutes, Directors' Meeting, April 14, 1941; The Georgia Marble Company (Official Record), April 14, 1941, to May 29, 1946, p. 22.

Company affairs demanded the attention of the executive committee rather frequently during the remaining months of 1941. Decisions had to be reached concerning certain problematical situations, concerning the disposition of certain assets. It was truly a year of action in the company.

a) An office was established in Atlanta along with continued maintenance of the office in Tate, Georgia.
b) Several parcels of real property were sold (in some instances mineral rights were reserved; they were not held back in other cases).
c) Consideration was given by the executive committee to the application of new sales techniques to procure more business and to the loss of sales brought on by "no-monument cemeteries."
d) The need to establish an independent pricing policy as well as a satisfactory pricing structure was recognized and action taken.
e) Continuation of the company's employee group life insurance program was authorized, but it excluded people who no longer had active company status unless they paid the entire premium cost.
f) Compulsory retirement at 65 was established for officers and employees. All beyond this age at the time had December 31, 1941, set as a retirement date for them.[3]
g) A satisfactory agreement with the bondholders was evolved.
h) For a saving of $1,000 a year, the listing of the company bonds on the Baltimore Securities Exchange was withdrawn. It was informally understood that an Atlanta securities organization would make a market for these bonds.
i) The board authorized the sale of all miscellaneous securities owned by the company.
j) A $46,000 claim against the Acacia Mausoleum in Chicago was sold for $12,000. The statute of limitations prevented any other action.
k) Claims against the Light Pink Marble Company were settled with an agreement for payment of $5,000 cash and the shipment of 20 carloads of light pink marble.
l) A settlement was reached with certain of the Tate Estate beneficiaries for a $45,000 note.
m) The power plant was disposed of for $26,000.
n) Lands jointly owned by the S. C. Tate Estate and the company were divided and appropriate deeds were drawn.
o) A more accurate accounting system was ordered for the Nelson plant, one that would truly reflect the profit and loss relationship.
p) Consideration was given to the opportunities for improving profits through utilization of waste stone. Decisions relating to the Serpentine properties at Holly Springs had to be given. Production of medicinal calcium from sawing and rubbing bed waste was considered.

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[3] The board of directors, upholding action of the executive committee, provided for the retirement of Mr. Alex Anderson among this group, with the title of senior consultant. Stipulations for his stay in Florida for three months in the interest of his health carried a continuation of his salary of $500 per month through that period with an extra bonus upon his return: cancellation of a $1,700 note which the company held against him. But the board also felt it desirable to stipulate that if Anderson failed to go to Florida, his salary would be cut to $225 per month on the retirement date. Or, if he cut his stay short of three months, the salary cut was to be effective upon his return.

q) In the management structure, weaknesses were pinpointed: certain employees were relieved of their responsibilities or retired and new personnel was procured.[4]

r) Building improvements were made at the Tate plant, with a concrete floor added; some production bottlenecks were eliminated through layout changes.

s) A number of employee houses were provided with electric service.

t) For handling marble in the yards, tractors were substituted for mule power with a cut of 50 percent in manpower requirements in this area.

u) Various alternatives were considered relating to the status of the Nelson and Marietta plants.

v) War defense enforcement of material allocation made necessary the seeking of defense work in order to procure an adequate supply of saw blades. It had to be recognized, however, that there was a serious shortage in procurement of this type of business.

The opportunity came, in early December, 1941, for acquisition of the business, assets, and personnel of The Georgia Marble Finishing Works at Canton, Georgia. It had always had operations related to those of The Georgia Marble Company, and it has been reported that each company attempted to exploit its position in dealing with the other. The Finishing Works was dependent on Georgia Marble as its source of stone. And, likewise, the company had, under Col. Sam's management, depended on banking associations of some officers of the Finishing Works.

Now, the efficiency of the production at the Canton plant was never under criticism, either in years of high volume sales ($600,000) or, even in the latter years of low volume sales ($200,000), when the Finishing Works was caught in the yoke of a price squeeze on its cubic stock and when management's vocal anti-Roosevelt attitude resulted in the calling of all salesmen in off the road. During its period of operation, 1904–41, the Finishing Works had sales of $20,000,000, with a net profit of $4,000,000. What reasons could be given for the acquisition of a company which seemed destined to close its operation and to liquidate its assets?

Fifty-one percent of the stock of the Finishing Works was tied up in the R. T. Jones' Estate, which was understood to be confronted with the need to raise cash for tax purposes. The first plus factor for acquisition was that the Finishing Works had, among some of its key management personnel, people with desirable management proficiency, particularly in the area of production.[5] The Finishing Works also had an inventory of 40,000 cubic feet of silver gray marble; this was a second feature making this company desirable for acquisition. At this time The Georgia Marble Company quarries were not producing any silver gray, a type of marble which was in considerable demand.

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[4] Among new personnel brought into the company at this time was Mr. William Vance. A loan officer with The Trust Company of Georgia, he had been brought into the company as monumental sales manager. This was not his first association with the company. An engineer by profession, he had, during the 1920's, worked in the Florida boom. Then, he began a seven-year period of employment with the company in the Marietta plant. During this period he was involved in many different kinds of activities, from which he probably got "marble dust in his veins." But he joined GMAC where he says "I received my degree in Business Administration." After another short spell with the Marietta plant of the company, and an interval in the banking business, he indicates he welcomed the opportunity of reassociation with The Georgia Marble Company under the new management.

The best terms seemed to be: a cash payment of $25,000 and an issue of $62,500—5 percent preferred stock of The Georgia Marble Company;[6] a one-year lease on the plant facility at Canton with the option of cancellation after this time upon a 60-day notice. A stated conservative value of the equipment and machinery of the Finishing Works was estimated at $30,000. The transaction was consummated, effective December 31, 1941.

The advent of war with its continued pressure on the civilian sector of the economy had its impact on The Georgia Marble Company. The demand for monumental products continued strong, but the cutback in civilian construction, with little demand for marble to be used in defense construction, necessitated certain changes in production and administration of the company. The field sales force was cut back; the Atlanta office was maintained with a minimum force to handle those few situations that did arise in the structural field. Production was chiefly in monumental products.

Mr. Cowan, now president, continued the task of rebuilding the company.[7] A bonus arrangement, dependent on company profits, was worked out with him. Since the freight cost of shipping marble blocks from the quarries to the Marietta plant added 50 percent to production costs, it was decided that the liquidation of the Marietta plant was an economic necessity. Also, the local electric distribution system serving Tate, Marble Hill, and Nelson, Georgia, communities, which had been owned by the company, was sold to the local Rural Electrification Administration. Other liquidations were carried out as well.

Because of the policy of management in the liquidation of all assets not useful in goal achievement, there was criticism that efforts were being made to strip the company of all salable assets to recover costs of investment incurred by the Georgia Marble Holding Company. The stockholders were given a six-months' report in 1943 as an answer to this criticism. (See Exhibit 1.) In addition, the board of directors passed a resolution which provided that no director should purchase company assets unless these had been first offered to the public on a bid basis.

Efforts to set up a school district at Tate, Georgia, and to float a $50,000 bond issue to enable the company to sell the school building were unsuccessful. Finally, the building was turned over to the school district for a $1,000 promissory note.

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[5] Two of these were S. E. Hyatt, their plant manager, and George Doss, who was production manager of The Georgia Marble Finishing Works.

[6] The cash payment of $25,000 was to be obtained from the bond trustee who had received the $26,000 proceeds from the sale of the power plant.

[7] Mr. Morton had been elevated to chairman of the board of directors.

EXHIBIT 1

To the Stockholders of The Georgia Marble Company:

Six months of 1942 having past, your management believes that an interim report would be both appreciated by you and would help you to understand what has been accomplished in this time.

These six months have each shown a net operating profit. It is impossible to make any dependable forecast of what will be the result of the next six months. Conditions brought about by the war make it absolutely impossible to forecast and extremely difficult to establish any plans. We can say that we are being as conservative as possible and are making our plans to meet any conditions that may arise, as far as possible. Total business in these six months is considerably greater than last year, due in a large measure to the acquisition of the Georgia Marble Finishing Works.

Under the authority of the Board of Directors our electric distribution system, furnishing electricity to the tenant houses of the towns of Tate, Nelson and Marble Hill, was sold and the money received from this was applied toward reducing our first mortgage bonds.

Your management, with the approval and under the direction of the Board of Directors, has been liquidating certain plant items which have not been absolutely essential to the operations of The Company. Two large compressors from Tate and a crane and runway from Marble Hill, along with some other items, have been sold at very good prices. Some of these items had not been used for many years and no use could be seen for them for some years to come; other items would not be used for the duration of the war and after the war is over can probably be replaced to better advantage at lower prices.

Your Board of Directors decided that it was inadvisable to continue maintaining the Marietta plant any longer and it was decided to liquidate it. This has, in a large measure, been accomplished and fair prices received for most of the machinery. The market for critical machinery items made it possible to secure the best prices. As a large part of this had been depreciated, a net profit from the sale of these capital assets has been made. The proceeds from these sales were applied toward reducing the outstanding 6% first mortgage bonds. This resulted in reducing the number of outstanding bonds to a point where it was deemed best to refinance. The Directors authorized this to be done and your management has succeeded in placing bank loans at more favorable rates of interest, the proceeds of which have partly been used to retire the balance of these first mortgage bonds. This operation will be completed by August 1, 1942 and the mortgage on the properties is now being released.

Monthly payments toward retiring the 5% preferred stock issued at the end of last year to finance the purchase of the Georgia Marble Finishing Works resulted in over half of the amount owing on this preferred stock being retired by June 1st. It was therefore decided to retire the balance of this stock, which has been done as of July 1st, so that after that date none will be outstanding.

We have also paid in full the deficiency in the income and excess profits tax for the year 1936 and the interest accumulated on this since that time. This tax case was contested and finally decided in March of this year, which resulted in establishing a certain saving to us in the amount claimed by the Government.

Very truly yours,
The Georgia Marble Company
James R. Cowan,
President.*

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* Directors' Meeting, July 16, 1942. (The) Georgia Marble Company. (Official Record.) April 14, 1941 to May 29, 1946, p. 130–131.

In January, 1943, the board of directors authorized an advertising budget of 2 percent of anticipated sales. (See Exhibit 2.) Also, upon recommendation of the auditing firm, $930,000 was written off from the surplus account to more nearly represent actual conditions. This had accumulated during early years of operation through discounts on sale of company bonds, sale of stock, and writing up of railroad asset value.

EXHIBIT 2

The Georgia Marble Company (C)
Consolidated Income Statement, 1941, 1942

	1941	*1942*
Gross sales		
Monumental sales	$ 693,710.82	$ 989,815.91
Interior and exterior sales	294,530.93	235,263.95
Rough blocks, scrap, and sundry sales	134,042.71	85,671.56
Total Sales	$1,122,284.46	$1,310,751.42
Less freight, discounts, returns and allowances	67,305.51	80,392.22
Net Sales	$1,054,978.95	$1,230,359.20
Cost of sales	851,402.93	974,944.81
Gross profit on sales	$ 203,576.02	$ 255,414.39
Deduct		
Selling expenses	$ 81,127.66	$ 91,159.63
General and administrative expenses	116,856.41	110,648.58
School and dwelling maintenance	55,715.46	54,694.68
Dwelling rentals	41,192.87 (L)	36,732.18 (L)
	$ 212,506.66	$ 219,770.71
Net profit or loss (L) from operations	$ 8,930.64 (L)	$ 35,643.68
Other income	$ 11,230.52	$ 12,717.47
Less miscellaneous income deductions	$ 17,403.11	$ 9,604.49
Other income (net)	$ 6,172.59 (L)	$ 3,112.98
Net profit or loss (L) before other deductions	$ 15,103.23 (L)	$ 38,756.66
Other deductions		
Interest on bonds	$ 23,278.24	$ 11,616.17
Interest on notes payable, and so on	5,198.20	6,262.31
Amortization of debt discount and expense	1,649.44	668.49
	$ 30,125.88	$ 18,546.97
Less net profit from disposition of capital assets		
Net profit from disposition of buildings and equipment	$ 37,966.52	$ 73.295.08
Net loss on disposition of investments	...	62,679.59
	$ 37,966.52	$ 10,615.49
Other deductions (net)	$ 7,840.64 (L)	$ 7,931.48
Net profit or loss (L)	$ 7,262.59 (L)	$ 30,825.18

By late 1943, Mr. Cowan estimated that proceeds from the liquidation of the Marietta plant were in the neighborhood of $150,000. At this time the value of the timber on the Amicalola Dam site property was $100,000, with an estimated 12 million feet of timber suitable for cutting.

The board concurred with Mr. Cowan in making the stock currently held in the company treasury available to executive employees on an at-cost basis.

The sale of burial vaults had reached such proportions by early 1944 that the establishment of a position of vault sales manager was considered. Then, it was decided to move to a vice-presidency certain officers with considerable areas of responsibility. This was not a new policy, since Alex Anderson, manager of the Nelson plant, had been vice-president also. And Mr. Litchfield, whose place in the organization was really that of corporate secretary, was at this time vice-president. Upon the recommendation of Mr. Cowan, president, Mr. William Vance became vice-president in general charge of sales and Mr. S. E. Hyatt, vice-president in general charge of production. Throughout the period the market demand was primarily for monumental stone, with the market for building and construction marble negligible.

But war conditions were changing and seemed to indicate a conclusion. In anticipation of this, the officers could see the revival of a market for structural stone. There seemed to be a need for launching a plant and equipment modernization program that would also encompass production for this area. In preparation for such a program, T. J. Durrett, Jr., was employed as a consulting engineer to work out the details.

Also, there seemed to be a need to re-establish a sales organization to cover the structural stone market. Previously, it had been company policy to maintain sales offices in the major population areas of the North and Northeast. Now, the company, after some extensive investigation, entered into a sales contract with Huntley-Kretzmer, a sales engineering firm. The organization represented the Alberene Stone Corporation of Virginia. There was a bilateral benefit from this arrangement. It gave an engineering sales agency a group of complementary products, while it provided The Georgia Marble Company with an established sales organization in the heavily populated areas of the North and Northeast.

After 40 years of service with the company, Mr. H. L. Litchfield retired on July 31, 1944. Shortly afterward, two others, the treasurer and the manager of the Nelson plant, were elevated to the vice-presidency. Among other important considerations during 1944 was the need to negotiate a new lease with the S. C. Tate Estate. (The existing lease was due for expiration in 1959, but no satisfactory planning and execution of capital expenditures could be achieved until the status of a new lease was established.) The executive committee allocated $200,000 for new machinery, repairs, and equipment in that year; a derrick was purchased for the quarries. The C.I.O. was recognized as the bargaining agent for the workers and a contract was signed. Final disposition was made of the mausoleum assets which had been carried over from the 1920's. Option was taken on some Elberton granite properties.

More efforts were directed toward preparation for meeting the market demands that would come with conversion after the war. The year 1945 brought ordering of new equipment, authorization of more capital expenditures, financial arrangements for the modernization program. Durrett's performance was quite satisfactory; and, as chief engineer, he was made a vice-president early in the year. Consideration was given to the opening of the company's granite quarry property at Elberton. Sanitation facilities were authorized to be provided at the Tate Plant and at the Tate High School. Absence of satisfactory medical services at Tate pointed out the need for the establishment of a clinic there to attract adequate and competent medical personnel. As an incentive to this project, up to $10,000 was to be contributed by the company.

The manpower situation improved and, by the latter part of 1945, orders were being received for building and structural marble. Among these orders was a $85,000 order for blocks to be used in the St. Patrick's Cathedral in New York City. And President Cowan was authorized to investigate the possibility of acquiring a lease on the travertine deposits in Randolph County, Georgia. But, lease negotiations with the S. C. Tate Estate collapsed without further explanation from the Tate Estate. The next year the board of directors accepted Mr. Cowan's proposal to establish a Delaware corporation to operate the company-owned timber lands.

The program of renovation was moving ahead under the thoughtful deliberation of officers to place The Georgia Marble Company as an organization of which Georgians and the South could be proud. Directors and management of the company perceived such a position as one objective. However, there was yet another end in view. The potential of the company being what it was, it could well serve as a nucleus about which to add other related activities.

The Georgia Marble Company (D)

Because of postwar shortages, it was necessary to look for many items of equipment by way of government surplus property sales.[1] It was not possible to move directly from coal-fired to diesel-powered locomotives and railroad cranes. Because of deferred delivery, it was expedient to make the transition by way of oil-fired steam units, equipment which was subsequently replaced by diesel-powered units. As rapidly as the "old fashioned" equipment had replacements, it was sold.

During this period, thought was given to what might be done with scrap and waste marble. The company's contract with Thompson-Weinman Company, signed in 1937 for a period of 10 years, was only about 18 months from its terminal point. The Georgia Marble Company had the option of renewing the agreement which made provision that Georgia Marble should not grind finer than a "200 mesh-screen," while Thompson-Weinman should not grind stone coarser than this size. Because of the company's inability to supply Thompson-Weinman's demands during the war period, the latter company had gone to Alabama to acquire some marble properties there.

Renewal of the Thompson-Weinman contract was a controversial point. Construction of a plant to convert the waste to lime was being considered. Likewise, officials were thinking of the expediency of establishing grinding facilities and exploring the chemicals market for powdered and marble granules.

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[1] Mr. William B. Tate, Jr., was a part of the modernization program in scouting out these items. He joined the company after having completed his military service with the Navy. A graduate engineer, a son of a cousin of Col. Sam, his employment had actually preceded his military service by about 10 days. His first assignment was that of assistant to Mr. Durrett, the chief engineer. In this position he aided in the renovation projects for the railroad, water supply, quarry pumping, and other general engineering work.

The Georgia Marble Company (E)

The Dorr Company was employed to make a research study surrounding the establishment of a lime plant. About the middle of 1947 this study was completed.[1] Using it as a basis, company officials decided not to renew the lease with Thompson-Weinman but immediately to start construction of facilities to produce up to "347" powdered screened marble. The large calcite deposits under company control seemed to dictate this as the best course.

It became the responsibility of Mr. John W. Dent, soon after his alignment with the company, to implement the decision, as he headed the newly begotten Calcium Products division. Conditions seemed to dictate first construction of a dry mill plant. The stringency of equipment and construction materials procurement made this a difficult undertaking. Because of postwar shortages, structural beams had to be of wood instead of steel; electric motors, frequently being of obsolete types, were picked up as one of a kind here and there. Pilot runs of this first dry-ground plant began in February, 1948, and the plant went into full production the next month. Already, plans were being carried out for the construction of a wet-ground plant.

It was William B. Tate, Jr., who served as the sales force of the Calcium Products division, later becoming its sales manager. His confidence in the future of chemical applications of marble had dated back to the time of Col. Sam. Bill had told him that this was the area where a bright future lay for the company. But to Col. Sam this had been only a sound of a young engineering graduate who needed a practical viewpoint. Bill sold to the cast stone dealers, to the chicken feed manufacturers, and to other similar consumers of crushed marble.

When the wet-ground plant began to feed the production stream, the division flexed its muscles and grew with amazing rapidity. The addition of other production facilities became necessary. Soon the division's products were going into items other than brick, chicken feed, cast stone, terrazzo, and so on. Rubber goods, chewing gum, paints, and numerous other items were becoming a part of the growing spectrum of its uses.

During the period when the Calcium Products division was being established, the structural and building stone operation was moving ahead. The monumental province continued to hold its own in dollar sales, but, as was to be expected, it became a less important phase of the company's total operation.[2] The lease on the plant building of The Georgia Marble Finishing Works in Canton, Georgia, was terminated in 1949, with its equipment being transferred to the Structural division at Nelson.

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[1] In April, 1947, Mr. John W. Dent resigned from the production-managership of Thompson-Weinman, a position he had held for six years. He became affiliated with The Georgia Marble Company in June, 1947.

Officials of the company, in early 1951, became aware of the possibility that they could acquire the physical properties of the Rockwood, Alabama Limestone Company. Possessing limestone deposits, this company was producing stone for exterior building work and for agricultural limestone. While the sales force of The Georgia Marble Company was adequate to absorb these additional products, at the same time it gave an opportunity to meet the price demand for exterior stone at about half of the price of marble.

A wholly owned subsidiary corporation, The Alabama Limestone Company, was formed in November, 1951, to take over the limestone operation. James R. Cowan was elected chairman of the board, S. E. Hyatt was made president, William L. Vance, Jr., vice-president in charge of residential sales, and G. W. Putney, vice-president and general manager. Shortly after the coalition, it became necessary to shift from surface to underground quarrying operation because the surface stone deposit was almost depleted. This change in method of quarrying was an innovation in the limestone industry.

By way of merger, The Georgia Marble Company acquired the Tennessee Marble Company of Knoxville, Tennessee, in midyear, 1953.[3] This organization had owned finishing plant facilities which fabricated highly decorative interior marbles from its quarries at St. Genevieve, Missouri. Also acquired in this merger were the plant and quarries of the Green Mountain Marble Company of West Rutland, Vermont. This latter operation gave to The Georgia Marble Company additional quantities of white marble and other color types that it did not previously have. The proximity of this facility to the Northeastern markets gave an added transportation advantage.[4]

James R. Cowan, at 63, was approaching the age of retirement. It was time to give consideration to the selection of a successor. The person selected would be made an executive vice-president for a year, at the end of which time he would assume the presidency with Mr. Cowan being elevated to chairman of the board.

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[2] Sales were made in both rough block and finished form. 1950 monumental sales accounted for 51 percent of gross dollar sales, building marbles 23 percent, and sundry 4 percent. In 1950 Calcium Products sales comprised 22 percent of total sales.

[3] This was accomplished through exchange of stock and a lease interest in one of the less valuable granite quarries in Elberton, Georgia. The company continued to own very valuable granite properties in the Elberton area. The Tennessee Marble Company had been owned by the Coggins group who were primarily interested in granite operations.

[4] At the time the Green Mountain operation was taken over, its quarry activities were being carried on underground. The average time taken to move stone to the surface after its extraction was eight hours. Under the new ownership, a tramway was installed and the time of removal was reduced to 10 minutes.

To find a new president, some eligible person could be brought in from outside the company, as had been done with Col. Sam and when Mr. Cowan became president. However, four top contenders in the company seemed young and vigorous enough to give the company a dynamic leadership.

John W. Dent had a varied background, some years in a college agricultural training program, a commercial school course in bookkeeping and shorthand, a correspondence course in cost accounting. He had also been a hotel clerk, a bookkeeper in a textile mill, city clerk, city manager, production manager of a crushed marble operation, and, most recently, head of the Calcium Products Division of the company since 1947. His obvious competence in originating this new division had won for him the admiration of co-workers, subordinates, and superiors.

S. E. Hyatt had spent a year in railroading, after which he moved into the Georgia Marble Finishing Works at Canton. Here he had moved up the ladder to become plant manager. When this organization was consolidated with The Georgia Marble Company in 1941, he had gone ahead in production management, proving his competence with a broadened scope of responsibility until he had become responsible for the company's entire production operations.

William L. Vance, Jr., was in charge of sales for the company. An engineer, he had worked at this profession in Florida during the boom of the 1920's. He had spent seven years in the Marietta plant of The Georgia Marble Company in sundry roles as clerk, estimator, and so on. After a satisfactory period with GMAC and affiliation with the Trust Company of Georgia as loan officer, he rejoined the company in 1941 and had been responsible for rebuilding its sales organization into the creditable place it now held.

Thomas J. Durrett, Jr., an engineer by profession, had been a state engineer under the Works Progress Administration. It had been his responsibility to design and to implement the company modernization program in the postwar period. These activities brought his recognition within the company and he was placed in charge of the Tennessee operation when the Tennessee Marble Company was acquired in 1953.

These four men were vice-presidents. They had been placed in a position of equal status in 1952 in salary as well as in a small profit-sharing plan. The ages of these men covered a range of only about three years. Each of the four candidates was given an opportunity to discuss with Mr. Cowan the possibility and the desirability of his own election to the presidency. The directors, who were not officers in the company, then were given a voice.

The Georgia Marble Company (F)

In early 1954, Mr. John W. Dent was made executive vice-president, it being understood that the following year he would assume the presidency. T. J. Durrett was shifted to head the Calcium Products division, filling the vacancy created by the elevation of Mr. Dent.

Willingham-Little Stone Company, an organization concerned with high volume production of white fine-grain dolomitic limestone (actually recrystallized marble), was acquired in September, 1954. The quarries and plant of this company were located 15 miles to the north of the Tate operations. The purchase seemed desirable for a number of reasons. Its proximity made possible executive supervision with limited amount of travel. Acquiring this company would enable The Georgia Marble Company to serve a broader market by sale of a material that was the accepted standard for chips used in white terrazzo. The physical characteristics of the items produced by the Calcium Products division made them undesirable for this purpose. The nearness to the Florida construction market would make this material a welcome addition. The "fines," a by-product, were unsurpassed in quality for use as agricultural limestone. There was an available market for this also.

From December, 1941 to 1955, J. R. Cowan had had a long laborious task but his fellows concluded that, in many respects, he had done it well. He had taken a sick company and moved it on the way toward becoming the giant of its industry. He had to do many things which, it is reported, were to him unpleasant, but, in the interest of all, he did what to him seemed best. Statements about him indicate that he was a driver for efficiency and a good judge of men. He apparently acted also on the premise that a man had to be past his fortieth birthday to achieve his best potential. A month after becoming chairman of the board, Mr. Cowan died. Mr. John W. Dent became president.

The board of directors, at their August meeting in 1955, authorized the establishment of a stock option plan for Mr. Dent, 4,000 shares, for Mr. Hyatt, Mr. Vance, and Mr. Durrett, 2,000 shares each. The market at this time was $30 per share and, under Internal Revenue regulations, the price was $25.50 per share. These men were given five years to exercise their options.

Two significant personnel changes occurred in 1955. Bill Tate, who had resigned in 1953 to become sales manager for Thompson-Weinman, was brought back to Calcium Products division as sales manager. Soon after, he was made a vice-president of the company. By this time, the growth and future of the company seemed to dictate the procurement of a financial officer who was a recognized authority on income tax.

Arthur Andersen, who had been serving as auditor for the company for a number of years was requested to make some recommendations, as was the accounting firm of Ernest and Ernest. Each recommended two or three potential candidates. As Harry Mathewson of the latter firm brought in one of their recommended candidates for interview, he himself was spotted as the man for whom the company had been searching. Subsequently he became financial officer of the company.

It had been the general policy through the years, as new acquisitions were made, to continue operation of each newly acquired organization as a division. In fact, to a considerable extent, these companies were carried on as separate entities. No consideration had been given to establishment of a uniform policy of depreciation, of centralized control over accounting, credit, purchasing, capital expenditures, cash, labor relations, and so on. It seemed that this general policy needed to be re-examined in the light of certain conditions that had been noted. Several weeks were required for auditing the records of each division, a fact which added to the cost of this auditing operation. Also, individual customers, dealing with more than one division, were occasionally paid up on a current basis with one division while very delinquent with another division of the company.

Facing officials of the company was the question of centralization versus decentralization. There was a need to centralize operations without impairment of the effectiveness of the various divisions, or, alternately, a need to correct inefficiencies in the various operations, leaving them as they existed at the time.

The Georgia Marble Company (G)

The company elected to centralize. The effectiveness of centralization, in terms of savings through reduction of personnel, seems to have been obscured by the continued growth of the firm. But it has been concluded by management officials that the very real problem of obtaining and developing personnel to assume the increased responsibility which has accompanied the growth experienced in the various divisions has been lightened considerably by the centralizing processes.

There had been a change in the ownership of Huntley-Kretzmer, which was now Albermar Agency. Some of the top people of that firm had been brought into the company as new partners. The Albermar Agency was becoming concerned about the effect of present trends at Alberene Stone Corporation of Virginia on its own operation. The corporation was eight months in arrears in delivery; it seemed to be in need of an improved management.

Here for The Georgia Marble Company was a further opportunity to diversify its activities in the stone field. Eighty percent of the Alberene production went into chemical laboratory installations; the remaining 20 percent was Serpentine, going into structural work. This Serpentine would complement other sales of the company in the structural field. Another apparent advantage would be control over all products included in Albermar sales. Controlling interest in the Alberene Stone Corporation of Virginia was obtained by The Georgia Marble Company.

Not long after, rumors began to circulate that the stone deposits owned by Alberene were nearing depletion. This brought a hurried huddle at The Georgia Marble Company. An extensive core-boring survey of the Alberene properties was conducted. This was something that the company had never attempted to carry out on its own properties. The results of the survey refuted the rumor and proved quite disturbing to the previous owners of Alberene Stone. It made possible more positive planning and action in the operations. Subsequently, delivery time was reduced from eight to two months. This experience made the company aware of benefits to be gained from carrying such an exploratory survey on in its other properties.

The services of a professional geologist were procured later for a core-boring survey for Georgia Marble properties. Some officials see, in retrospect, this program as a not too effective operation because of the lack of competent drilling crews and equipment, though these deficiencies were finally corrected.

In 1957 the board of directors authorized the creation of a major medical insurance program for all executives and salaried employees, the company paying the cost for the individual employee, the employee, the cost for each dependent. The insurance company was to pay 80 percent of the cost of medical bills up to $10,000; the employee, 20 percent. A life insurance program for the executives and salaried employees equal to 1½ times the employee's annual salary had already been provided.

The board of directors approved the establishment of a profit-sharing program for salaried employees in 1958. To be eligible for participation the employee must have been in the company for a period of three years. The basis of computation is 15 percent of the employee's annual salary, excluding any bonus. In addition, an employee may contribute up to 7 percent of his salary from his own funds, if he so elects. Upon termination of service prior to retirement, the employee, after a period of five years, may draw out 10 percent per year, and increasing increments of 10 percent per year, until all benefits have been withdrawn.

At the same time that the profit sharing was established, provision was made for the compulsory retirement of salaried employees at 65, for members of the board of directors at 70. Permission was granted to those who had not at this point accumulated funds in the profit-sharing program to continue their employment. There were about seven people affected; they were retired early in 1960.[1]

The greatest emphasis in the postwar period had been placed on the Nelson Plant and on the Calcium Products division.[2] Modern methods and equipment had not been as extensively utilized in the Monumental division at Tate. Some changes here were undertaken in 1957. Additional equipment and production lines were set up. However, no changes were made in the marketing concept: dependence on the large dealer as a primary source of sales for this division.

Another change in the company policy during this period was the launching of a program to employ a number of young engineers. Contrary to his predecessor's belief, Mr. Dent did not adhere to the fact that a man had to be in middle age before he could achieve his optimum productivity. But the modernization program and the employment of young engineers met resistance at the Tate Plant. It seems that a higher proportion of older workers had accrued to this plant than at the other operations. A common attitude was, "If it was good enough for Col. Sam, it's still good enough for me." Many of the workers did not see any reason for change. Their basic distrust of "outsiders" did not simplify the task of the engineers. Such conditions have retarded progress in the Monumental division more than in other areas. It was never the intent of the company to eliminate jobs but, through improved operations, to create more jobs. The rank and file seem to lack an appreciation for the economic results of Col. Sam's policies.

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[1] Each received 20 percent of his annual salary for those years not covered by profit sharing. This, with Social Security benefits and income from investments, was a substantial accrued earning.

[2] After considerable wooing by a former college classmate, Tom Durrett resigned from the company to become involved in a different industry. He was replaced as division manager of the Calcium Products Division by William B. Tate, Jr. Bill, already a vice-president, was soon appointed to the board of directors.

Durrett had exercised only 1,000 of his 2,000 shares of stock option given him in 1955.

For a period of time the Calcium Products division had depended on the laboratory control program established by Dr. Milton Gallagher of the Industrial Chemistry department in the University of Chattanooga. Dr. Gallagher had acted on a consulting basis until 1957, when he became a full-time employee of the company. At the same time, Bob Hall, a paint chemist was also brought to the company. It was intended that these two would carry on a research program. However, the technical service demands made on them left little time for the achievement of basic research in production and product improvement, in the research laboratory that had been equipped for this purpose. Though research project objectives were established, nothing was reported back.

In midautumn, 1959, the board of directors approved the capital expenditure for the construction of a research laboratory facility, to be located separate and apart from any of the company's operational activity. Past experience had proved that close proximity to operations might be advantageous for operations but not conducive to basic research, of which the company had immediate need. To give the research center project a fitting send-off, 24 of the company's top officers were assembled into a brainstorming session. The objective of this conference was to gain support of all officers in this endeavor, and to map out a *collective* program of research for the company.

The Mineral Bluff operation to the north of Tate was acquired in 1958. In January, 1960, in an exchange of stock, the company acquired the outstanding stock of a joint venture operation, Consolidated Quarries. It was a 1,700 acre granite deposit near Atlanta with little or no overburden. The object of this acquisition was the continuation of diversification in the stone industry. Located near a thriving market for concrete aggregate for ready-mix concrete, road aggregate for the road-building boom ahead, chicken grit, and so on, this operation was capable of producing 600 tons of crushed stone per hour. One 35,000 pound charge of dynamite provided a three-months' supply of stone for the crusher.

A project being done for the nation's Capitol building in Washington had overloaded the structural facilities at Nelson so that the excess need for production was spilled over into the Monumental division. This necessitated curtailed sales activity in this area. Many new sizable contracts were made in 1960. Among these was a joint venture to supply marble for the House of Representatives Office Building in Washington. The Capitol job, in 1960, moved toward completion, and the company made ready to chew into the "House Office Building job," the largest stone contract made in American history.

But there remain problems:

1. How to lighten the work load of the men in the top echelon.
2. How to fill the gap in the organization of "number 2 men" without dampening the enthusiasm of "number 3 men."

EXHIBIT 1

THE GEORGIA MARBLE COMPANY (G)
Balance Sheet
December 31, 1959

ASSETS

Current assets		
Cash		$ 1,476,153
Receivables, less reserves of $166,716 in 1959		2,338,680
Inventories, at average cost, not in excess of market		
Stone and stone products		1,758,039
Materials and supplies		444,251
Total Current Assets		$ 6,017,123
Investments, and so on		
Investments and miscellaneous receivables		$ 496,127
Prepaid expenses, and so on		125,094
		$ 621,221
Property, plant and equipment		
Quarry lands, owned and leased, at cost	$ 2,176,179	
Less: Reserve for depletion	1,333,247	$ 842,932
Land, buildings, and equipment, at cost	$11,094,803	
Less: Reserve for depreciation	5,613,080	5,481,723
Total Assets		$ 6,324,655
		$12,962,999

LIABILITIES

Current liabilities	
Accounts payable	$ 290,849
Accrued wages and other expenses	657,103
Accrued federal and state income taxes	534,442
Installment on mortgage notes payable within one year	25,000
Total Current Liabilities	$ 1,507,394
Mortgage notes on $1,065,000 of Vermont properties, 6 percent, payable $25,000 annually and $16,319 in 1969 (noncallable)	$ 216,319
Deferred income taxes for accelerated depreciation	$ 118,000
Minority interests in a subsidiary company	...
Stockholders' equity	
Preferred stock, 5 percent cumulative, $10 par value, authorized and outstanding, 94,901 shares (convertible, under certain conditions, into 5 percent subordinated notes)	$ 949,010
Common stock, $10 par value	
Authorized, 1,000,000 shares	
Issued and outstanding, 748,175 shares at December 31, 1959	$ 7,481,750
Paid-in surplus	574,016
Earned surplus	2,116,510
	$11,121,286
Total Liabilities	$12,962,999

3. Though the research center is in operation, how to destroy the research and development lag.
4. What to do about transportation costs and improved markets.
5. How to make the Calcium Products division less susceptible to the swings in the construction industry's cyclical pattern.
6. How to reduce quarrying cost.

In the thoughts and discussions of the board of directors and of the officers of the company are methods of exploiting to best advantage all of the resources at the disposal of the company. Finding new ideas and promoting self-improvement are two major needs of the company.

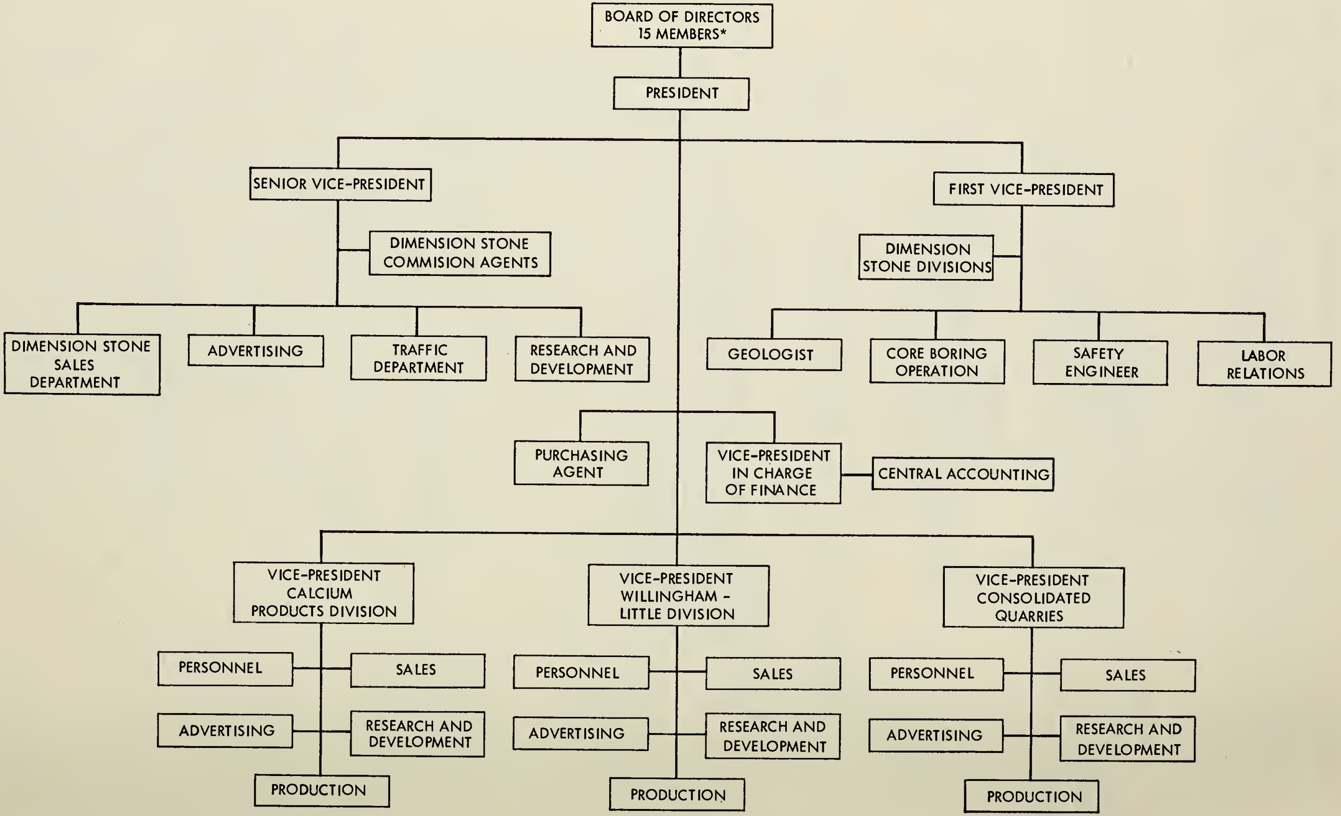
EXHIBIT 2

THE GEORGIA MARBLE COMPANY (G)
Income Statement for the Year Ended
December 31, 1959

Income	
Net sales	$17,560,265
Other income, net	50,377
	$17,610,642
Costs and expenses	
Wages, salaries and other compensation	$ 7,157,186
Materials, supplies, power, repairs, insurance, and other services and costs	6,824,108
Social security and general taxes	400,583
Depreciation, depletion, and royalties	720,105
Provision for income taxes	520,000
	$15,621,982
Net Income	$ 1,988,660

EXHIBIT 3

Organization Chart, 1960



* Five are officers of the company.

Southern Metal Products Corporation[*]

The Southern Metal Products Corporation is located on a 52-acre site approximately one mile beyond the limits of a Southern city of about 150,000 population. It is housed in a large one-story structural steel and concrete building consisting of 260,000 square feet of floor space. It operates three shifts and employs about 700 persons at full production. The plant building is owned by the company and situated on a well-traveled highway in a suburban section. A mainline railroad runs through the property. Switch tracks have been constructed to loading points in the plant. The building and equipment are in excellent state of repairs and the premises are orderly and attractive.

The company was incorporated under the laws of a Southern state in 1953 as the Metal Products Corporation. The name was changed to Southern Metal Products Corporation by an amendment to its charter in 1958. It is a wholly owned subsidiary of the National Metal Products Corporation which, in turn, is a direct and wholly owned subsidiary of United Metal Products Corporation.

The Southern Metal Products Corporation manufactures aluminum and stainless steel cooking utensils and small portable electrical household appliances. The major portion of its output is sold to United Metal Products Sales, Incorporated. The products are distributed to consumers through several well-known sales organizations in the United States, a leading manufacturer and distributor in Canada, and other distributors in England, Mexico, and Australia. Some of the products are sold under the company's own trademark, while others are sold under the trade names of distributors.

The National Metal Products Corporation manufactures stainless steel cooking and table service equipment and sterling silver flatware. The products which bear the company trademark are distributed by a direct-to-customer sales force operating in the 50 states and through district offices in Puerto Rico and Cuba.

The consolidated operations of United Metal Products Corporation include six major plants in the United States and one in Canada. In addition to the products of the two subsidiaries discussed here, it is engaged in the manufacture of aircraft structural components and defense materials. Also, one subsidiary is engaged in the printing business and multicolor lithographic reproductions. The company is involved in a phase of transition and overall development which may have some effect on the Southern subsidiary operating within the framework of corporate policy.

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[*] Prepared by Randolph G. Kinabrew, University of Mississippi.

The 1958 Annual Report of United Metal Products Corporation projected a satisfactory commercial period, but indicates that "similar optimism may not be expressed with regard to the defense aspects of this business." Unfilled defense orders decreased from $28,000,000 in 1957 to $18,500,000 in 1958. It was apparent that the manufacture of parts for aircraft structures by this company and others engaged in subcontract manufacture of similar parts was declining rapidly. The Defense Department was shifting from reliance on conventional aircraft requiring structural hardware to dependence upon missiles which make extensive use of propulsion, weapons systems, electronics, and ground handling equipment. Manufacture of equipment beyond the structural stage was being done largely by organizations well established in this field and in a position to engage in missile development as well as production.

In recognition of the probable impact of the transition program on future sales, the United Metal Products Corporation concentrated all of its air defense production at a plant in the North Central part of the United States. Non-air defense production was concentrated at a second plant in the same general area but in another state.

Even though this move enabled the company to effect cost reductions at both plants, the benefits are not likely to be permanent. There are indications that defense production at the second plant will come to a complete end in 1960. The company is prepared to maintain the facility in stand-by readiness under contract with the Ordnance Department for munitions production.

This type change in external circumstances requires reexamination of major company objectives and adoption of a new policy of greater dependence of company sales upon new developments in commercial operations. Future success of the business depends upon how well the company can make the transition from extensive production for defense to a greater volume of production for the commercial market.

The Southern Metal Products Corporation is an integral part of the transition program of United Metal Products Corporation of which it is a second-stage subsidiary. Its product line provides the company with a firm foundation in the small home appliance field. It has a backlog of technology in production and distribution accumulated over the preceding six years. This technology can be employed to assure continued production at capacity. Feasibility of future expansion may be determined by consideration of opportunities afforded through product research and development and acquisition of going concerns with similar or complementary technological advantages in small home appliance and related fields. There is some evidence that the Southern subsidiary is performing a vital role in the overall development of the company in this direction at the present time. The 1959 Annual Report of United Metal Products Corporation describes four new products recently released by its research and engineering group. All of these products are in production at the

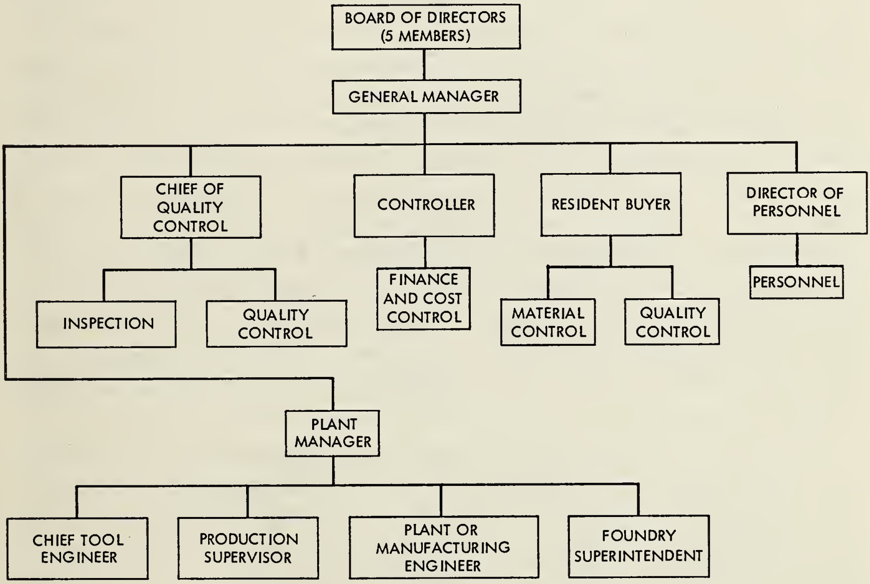
Southern subsidiary plant. It is significant that this facility approached capacity production during the same period in which the new products were placed in production. Under certain circumstances, the introduction of new products is the best way to absorb excess capacity. In situations of this sort, capacity production may not be attained economically without effective product research and development.

These recent developments in the Southern Metal Products Corporation reflect in a forceful way major corporate objectives of consolidation of position and acceleration of growth in the portable appliance and other commercial business for the 1960 fiscal year.

It may be concluded from current developments in major policy for the consolidated system of operations that the primary responsibility of management of Southern Metal Products is to maintain efficient production of existing products at capacity and remain alert to the need for manufacturing new products. Management of the facility is in the hands of a board of directors with administrative officers and executives organized informally and along functional lines as indicated in Exhibit 1.

EXHIBIT 1

Organizational Chart



To provide flexibility in administration, the company does not rely upon a formal organization chart with descriptions and responsibilities specified for each position for day-to-day management. Rotating committees are used frequently and communication is stressed by management. Cost, quality, and production control systems are in operation. There is an atmosphere of keen consciousness of the significance of these systems at the management level. Production workers are kept on alert for quality in production through a well-organized system of inspection. Inspection begins with the arrival of materials and ends with the exit of the finished products. One hundred percent inspection of goods in process is employed. Early detection of defects is vital to the control system.

In addition to the system of visual inspection, a system of statistical quality control is employed. Samples of work are taken at many stations from the foundry to the warehouse of finished and packaged goods. If statistical tolerances are wider than engineering tolerances, the source of defective products is in quality of material, skill of direct labor, or performance of machinery. Both the type of defect and the phase of the production process from which the sample is taken are helpful in locating the source of defects. The objective in making statistical quality studies is to give direction and emphasis to supervision, training, material purchasing, and maintenance of tools and machinery. Constant attention to and improvement in the performance of these functions will tend to reduce variations between statistical and engineering tolerances. The maintenance of a flexible budget is an important instrument of internal control in the hands of management. A sales forecast is made by the parent organization for each fiscal year. From the forecast, a production estimate is made for the Southern facility. Manufacturing cost estimates are made for the fiscal year. Material and direct labor cost estimates are added to manufacturing cost estimates to arrive at the total amount budgeted for the company. Capacity variance or rate of utilization of budgeted overhead by actual direct labor cost is computed and plotted graphically to show the changes in the rate of utilization of plant capacity. Capacity variance has been quite favorable since early in 1959.

A monthly unit cost record is made for each product-type by production departments. Likewise, total actual costs incurred by each department is calculated by product-type. By comparing actual costs with the amount budgeted for each department, management is afforded a quick view of production performance. Efficient and inefficient operations are readily recognized in this manner.

Plant Layout and Operation

The production process includes about 16 functional operations ranging in scope from the metal foundry, plastic press, and metal stamping operations at one end to assembly, packaging, and shipping at the other end. The foundry is administratively and physically separated from other production departments but interconnected by overhead conveyors and floor transportation. It contains six gas-fired furnaces and suitable molds mounted on metal stands for each type of casting required in production. Aluminum ingot, defective casting, and repossessed metal from drilling and cutting operations are fed into the furnaces which operate on a continuous basis.

Plastic components are molded by machinery from a compound made from powdered plastic. The molded plastic pieces are deburred by hand in the same general area in which the plastic press is located. They are placed in specially constructed conveyor cabinets and transported to the overhead powered conveyor track for temporary storage and transportation to other departments and the assembly line.

A group of small stamping machines is used to stamp out metal components. Most of the metal parts are small and fashioned from lightweight metal sheets, rods, and bars. Interchangeable dies make it possible to use the stamping machines for different operations. Stampings are transported by mechanized conveyors to other departments where they are welded, ground, and drilled. Likewise, aluminum castings are ground and drilled.

External metal components are polished by special purpose steam power machinery and transported by conveyor to the respective product assembly lines. The assembly lines are semi-machine paced.

Finished products are handled in the warehouse and loading operations by mechanized lift trucks.

Financial Position

Management does not release individual balance sheets for publication. However, the Southern Metal Products Corporation is a wholly owned subsidiary of National Metal Products Corporation. This parent company has formally guaranteed all contractual obligations of the subsidiary. The following tabulations are from the latest three balance sheets made available by the parent company:

National Metal Products Corporation

	Individual Fiscal September 30, 1956	*Individual Fiscal September 30, 1957*	*Individual Fiscal September 30, 1958*
Current assets	$4,371,729	$3,879,125	$5,336,732
Current liabilities	473,097	434,496	480,461
Net working capital	3,898,632	3,444,629	4,856,271
Current ratio	9.24	8.92	11.10
Net worth	7,041,155	7,229,304	6,539,490

Source: *Dun and Bradstreet Report*, September 2, 1959.

National Metal Products Corporation is a direct and wholly owned subsidiary of United Metal Products Corporation. The latest three balance sheets and income statements of that corporation available contain the following tabulations:

UNITED METAL PRODUCTS CORPORATION
Consolidated

	Fiscal September 30, 1956	*Fiscal September 30, 1957*	*Fiscal September 30, 1958*
Current assets	$21,588,791	$21,824,727	$19,756,887
Current liabilities	10,952,865	7,076,012	5,345,827
Net working capital	10,635,926	14,748,715	14,411,060
Current ratio	1.97	3.08	3.69
Net worth	19,597,407	20,196,304	18,788,611
Sales	28,578,143	44,453,978	35,007,768
Net profit	556,714	1,215,139	(L) 733,300
Dividends	598,560	598,410	592,921

L = Loss.
Source: *Dun and Bradstreet Report,* September 2, 1959.

The latest available balance sheet, income statement, and summary of consolidated statistics of United Metal Products Corporation are shown in Exhibits 2, 3, and 4 respectively.

EXHIBIT 2

UNITED METAL PRODUCTS CORPORATION
Comparative Consolidated Balance Sheet, September 30, 1957, 1958, and 1959

ASSETS	*1957*	*1958*	*1959*
Current assets			
Cash	$ 508,860	$ 1,027,999	$ 1,453,891
Marketable securities	2,304,485	2,281,779	2,199,839
Accounts receivable	10,567,235	9,905,650	9,492,427
Inventories	8,444,146	6,541,460	6,228,663
Deferred charges	824,188	385,687	1,093,453
Total Current Assets	$22,648,916	$20,142,575	$20,468,273
Investment in subsidiaries	$ 278,843	$ 278,843	$ 278,843
Other assets	149,532	126,667	117,227
Fixed assets			
Land, buildings, and so on	$ 9,736,660	$ 8,072,956	$ 8,431,459
Less depreciation	4,740,931	3,395,193	3,940,638
Net property	4,995,729	4,677,763	4,490,821
Total Assets	$28,073,020	$25,225,847	$25,355,164
LIABILITIES			
Current liabilities			
Notes payable	$ 2,625,000	$ 1,460,000	$ 451,378
Federal income taxes	1,262,682	644,629	1,085,565
Accounts payable	1,796,738	1,848,400	2,103,538
Accruals	1,391,593	1,392,799	1,442,789
Total Current Liabilities	$ 7,076,013	$ 5,345,828	$ 5,083,270
Debentures due	$ 160,000	$ 160,000	$ 160,000
Deferred income	$ 640,703	$ 931,408	$ 1,033,401
Capital stock and surplus			
Capital stock	$ 2,000,000	$ 2,000,000	$ 2,000,000
Paid-in capital	5,426,119	5,426,119	5,426,119
Capital surplus	155,386	155,386	155,386
Retained earnings	12,656,655	11,330,432	11,609,201
Total	20,238,160	18,911,938	19,190,706
Reacquired stock	41,586	123,326	112,212
Net stock and surplus	20,196,304	18,788,612	19,078,494
Total Liabilities	$28,073,020	$25,225,847	$25,355,164

Source: Compiled from *Moody's Investment Service Manual* and the *1959 Annual Report.*

EXHIBIT 3

United Metal Products Corporation

Consolidated Income Account, September 30, 1957, and 1958

(Includes Wholly Owned Subsidiaries and Excludes Canadian Industries)

	1957	*1958*
Net sales*	$44,453,979	$35,007,769
Cost of sales	33,393,689	24,991,287
Gross profit	11,060,290	10,016,480
Installment sales adjustment	130,386	290,705
Balance	10,929,904	9,725,777
Selling, and so on, expenses	8,468,552	8,654,974
Operating profit	2,461,353	1,070,803
Other income, net	88,258	394,658
Total income	2,547,611	1,465,461
Income taxes	1,332,471	797,600
Net profit	1,215,140†	667,861
Previously earned surplus	12,039,925	12,656,655
Dividends	598,410	592,921
Previous year renegotiation		1,401,162
Earned surplus	12,656,655	11,330,433

* After deducting $2,783,019 (1957, $5,044,356) sales of facilities to U.S. government at cost.

† Payment for renegotiation for the year ended September 30, 1953, was made during the year ended September 30, 1958.

Source: *Moody's Investment Service Manual.*

EXHIBIT 4

United Metal Products Corporation

Sales and Earnings, 1949–59

Year	*Net Sales*	*Net Income*
1959	$34,990,646	$1,161,676
1958	35,007,769	667,861
1957	44,453,979	1,215,140*
1956	28,578,144	556,715
1955	34,160,625	1,225,049
1954	45,974,305	1,721,960
1953	47,977,766	1,343,989
1952	37,879,744	1,616,839
1951	28,720,655	1,738,172
1950	26,964,510	2,532,401
1949	26,338,738	1,096,375

* Includes $216,580 nonrecurring profit of sale of plant.

Source: *Moody's Investment Service Manual.*

The Industry Situation

The Southern Metal Products Corporation manufactures two similar lines of products, namely, cooking utensils and small home electric appliances. Its output consists of about 20 or more separate items which are sold to and distributed to customers by national distribution organizations. In order to meet consumer preferences, the individual items often are packaged in different combinations. From the manufacturer's point of view, the different packages may be regarded as products requiring different packaging and shipping costs. Over a period of time the company manufactures about 60 different packages made up of combinations of the following items:

1. Steam iron.
2. Small electric cooker.
3. Portable oven.
4. Electrical control unit.
5. Electric frypan (2 sizes).
6. Griddle.
7. Pressure cooker, stainless cast aluminum.
8. Saucepan.
9. Dutch oven.
10. Automatic coffee maker, stainless steel.
11. Timing unit.
12. Cooker, stamped aluminum (3 sizes).
13. Cooker-canner, stainless steel.
14. Cooker-canner, stainless cast aluminum.

These products are distributed to customers as part of a broader line of cooking utensils and tools and electric appliances. As an indication of the scope of the industry line of home equipment required by the market, a standard publication in the field suggests a *minimum* set of utensils for the kitchen as shown in Exhibit 5. This standard publication also describes the most desirable features of utensils and small electric appliances for efficient use in the American home. The structural features are useful guides to designing products by manufacturers.

EXHIBIT 5

MINIMUM SET OF KITCHEN UTENSILS

1 saucepan—1 quart
1 saucepan—2 quart
1 cast iron skillet—8–10 inch
1 chicken fryer or Dutch oven
1 griddle
1 glass or china casserole—1 quart
1 glass or china casserole—2 quart
1 cooking rack
1 set graduated measuring cups
1 quart glass measure
1 one-cup glass measure (liquid)
1 set graduated measuring spoons
1 small spatula
1 rotary beater
1 paring knife
1 French cook knife
1 cheese slicer
1 cutting board
1 grater
1 blender
2 round baking pans—8 or 9 inch
1 loaf baking pan—10 by 15 inches
1 cookie sheet
1 muffin tin—8 cup
1 pie pan
1 set mixing bowls
1 coffee maker
1 teapot
1 set wooden spoons
1 wide spatula or pancake turner
1 can opener
1 bottle opener
1 tap opener
1 cooking fork
1 vegetable peeler
1 kitchen shears
1 rubber scraper
1 rolling pin
1 flour sifter
1 canister set
1 strainer

Source: Florence Ehrenkranz, and Lydia Inman, *Equipment in the Home* (New York: Harper & Bros., 1958) p. 74.

Small electric appliances may be divided into at least three functional groups. The first group includes the motor-driven appliances such as food mixers, grinders, and blenders. The second group consists of heating appliances like coffee makers, cooker-fryers, frypans, saucepans, Dutch ovens, double boilers, waffle bakers, griddles, roasters, and toasters. The rotisserie is the principal product of the third group of appliances which are both motor-driven and heating.

The minimum set of utensils and electric equipment required to equip a modern American home is a general guide to the direction in which the Southern Metal Products Corporation may expand production capacity. Also, the industry market line is sufficiently broad to afford opportunity for constant utilization of existing capacity through circular integration of manufacturing.

The Blaine Oil Corporation[*]

The Blaine Oil Corporation[1] was organized in 1901 in Oklahoma City, Oklahoma, from the combination of several smaller concerns engaged in the exploration for, and the production of, crude oil and gas. It was successful from the start and became an important participant in the significant openings of oil fields in the Osage (Oklahoma) field in 1919, the Seminole (Oklahoma) field in 1926, and the East Texas fields in 1930. More recently it has become an important producer in the "Golden Trend" area of South Central Oklahoma.

At the conclusion of World War II in 1945, the company decided to enter the refining and retail marketing areas; and after considerable study and investigation, a modern 20,000 barrel per day refinery was constructed at Lawton, Oklahoma. This plant consisted of an alkylation unit, a catalytic cracking unit, and a platforming unit and was believed to be competitive in operating costs with other comparable plants in the mid-continent area.

I. THE LAWTON REFINERY

The Lawton Refinery manufactures gasoline and other petroleum products from crude oil produced in the Central Oklahoma and East Texas areas. The plant can now process 35,000 barrels of crude oil per day. Exhibit 1 shows the organizational structure of the refinery. Notice that there are five operating divisions: (1) General Service, (2) Construction and Maintenance, (3) Petroleum Processing, (4) Technical Services, and (5) Chemical Products.

Exhibit 2 shows the organization of the Petroleum Processing Department. This division is responsible for the manufacture of all products. The processes by which crude oil is refined into gasoline are extremely complicated: complex, intricate, and expensive equipment is required. It is therefore important that any refinery have an efficient maintenance program. The primary responsibility of the Construction and Maintenance Department is to keep all equipment in good repair and operating at all times.

II. THE CONSTRUCTION AND MAINTENANCE DEPARTMENT

Major changes have recently been effected in the Construction and Maintenance Department. Exhibit 3 shows the organization of the depart-

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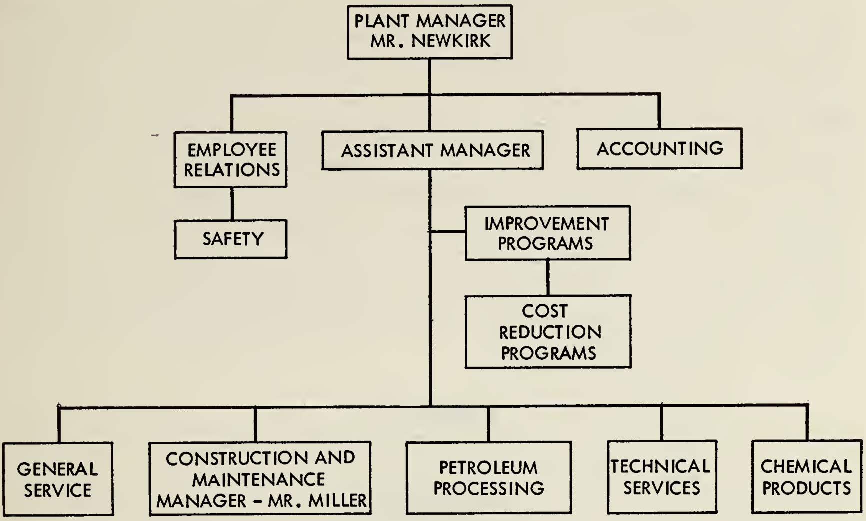
[*] Prepared by Edward C. Burris, Oklahoma State University.

[1] All names have been disguised.

EXHIBIT 1

THE LAWTON REFINERY

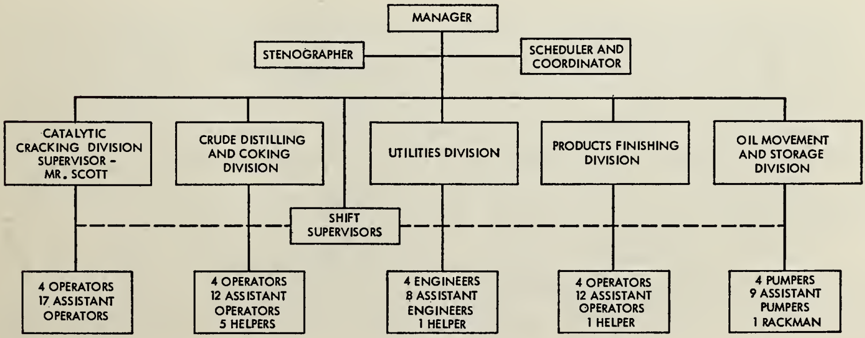


ment before the change. At that time, it was composed of a manager; a planning engineer; an inspector; and the Mechanical Engineering, Materials, and General Trades Divisions. The General Trades Division con-planning engineer; an inspector; and the Mechanical Engineering, Materials, and General Trades Divisions. The General Trades Division consisted of the electrical, Instrument, Machinists, Pipefitters, Metal Trades, Miscellaneous, and Service Craft Units. The total complement of personnel in the department as of August 1, 1959 (one month before the change), is given in Exhibit 4.

Formerly, the Construction and Maintenance Department had no planning system by which repair and maintenance work was coordinated. In

EXHIBIT 2

THE PETROLEUM PROCESSING DEPARTMENT

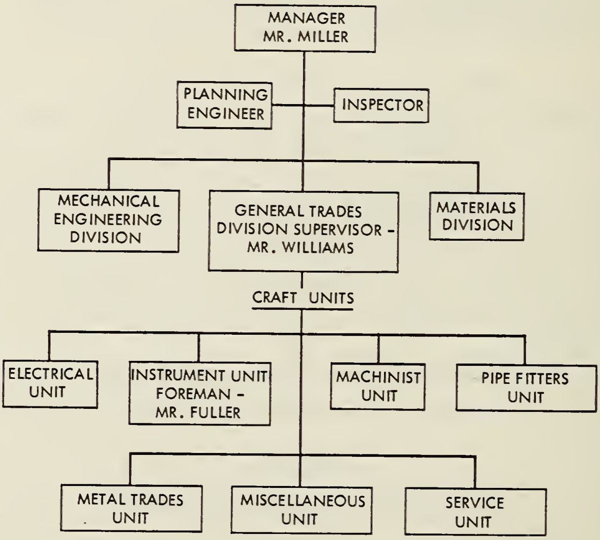


the absence of such a system, three procedures were followed by the department in performing maintenance work.

The first procedure involved the use of a work request form entitled "For Mechanical Work," on which the work to be done could be described and the time of performance specified. These work requests could be originated in either the craft units of the Construction and Maintenance Department or in the various divisions of the Petroleum Processing Department. They usually originated in the latter. The requests were approved by a craft unit foreman and a supervisor of a Processing Division, forwarded to the planning engineer, then to the General Trades supervisor for processing. If the planning engineer felt that the work described on the request involved a capital expenditure, he assigned to it a mechanical order number. This was the only record kept in connection with the work requests.

EXHIBIT 3

THE CONSTRUCTION AND MAINTENANCE DEPARTMENT



The second procedure involved the evening and midnight shift supervisors in the Petroleum Processing Department. These supervisors prepared pencil listings of all situations occurring during their shifts which, in their opinion, required maintenance work. These listings were considered emergency work which had to be performed during the following day, and were forwarded directly to the general trades supervisor for processing. No record of these work requests was maintained.

The third procedure involved oral communication. A supervisor in the Petroleum Processing Department would telephone a craft foreman and describe repair work needing attention in his unit, whereupon the

EXHIBIT 4

Construction and Maintenance Department Personnel as of August 31, 1959

Salaried Personnel	*Number*
Department manager	1
Planning engineer	1
Inspector	1
Mechanical engineering supervisor	1
General trades supervisor	1
Materials supervisor	1
Electrical foreman	1
Instrument foreman	1
Machinist foreman	1
Pipe fitter foreman	1
Metal trades foreman	1
Miscellaneous foreman	1
Service foreman	1
Total	13

Hourly Personnel	*1st Class*	*2nd Class*	*Helper*	*Maintenance Men*	*Tool Room Keeper*	*Casuals*	*Total*
Electrical	4	2	1	1	0	0	8
Instrument	6	2	1	1	0	0	10
Machinist	3	4	3	1	1	0	12
Metal trades:							
Welders	8	0	4	1	0	0	13
Burners	2	0	0	0	0	0	2
Pipe fitters	5	6	10	2	0	0	23
Service:							
Pipe insulators	3	3	4	1	0	0	11
Gatemen	0	0	4	0	0	0	4
Janitors	0	0	0	3	0	0	3
Casuals	0	0	0	0	0	21	21
Tank cleaners	0	0	0	4	0	0	4
Miscellaneous:							
Carpenters	2	1	1	1	0	0	5
Riggers	1	2	1	1	0	0	5
Heavy equipment operators	1	1	2	2	0	0	6
Total	35	21	31	18	1	21	127

craft foreman would detail the necessary personnel. The processing supervisor would frequently go directly to craftsmen working on equipment in their units and request that additional repairs be performed. Also, the shift supervisor could telephone craft foremen (or even individual craftsmen) at their homes after working hours, if, in the shift supervisor's opinion, work needed immediate attention. There were, of course, no records kept of oral work requests or of the maintenance performed in connection with these oral work requests.

The primary responsibility of the planning engineer was to coordinate the operations of the entire department. He, however, had a nearly impossible task. In trying to help people organize their work, he met continued resistance from the general trades supervisor and on down through the individual craft units. Some wanted help, but others resented advice, and any suggestion that they were not doing a good job created antagonisms. The foremen and the men, generally, wanted to continue as always. If they saw a job that needed to be done, they wanted to see that it was done immediately. To wait for a work request or for planning was, to them, a waste of time. The planning engineer was having little success. He therefore suggested to the Construction and Maintenance Department manager and to the general manager of the refinery, that an outside systems firm he asked to study the operations of the department and offer recommendations concerning a planning system. This proposal was adopted and Bradley Consultants was selected to study the problem.

III. THE STUDY

After a thorough examination of work procedures employed by the Construction and Maintenance Department, the systems people were convinced that unnecessary inefficiency existed. They quickly formed the opinion, for instance, that emergency work was excessive. To determine its status, records were kept for a period of 36 days. The record showed the following:

	Type of Work	
	Normal (From Work Request Form)	*Emergency (From Shift Supervisor's Lists)*
Number of requests	137	288
Percentage of total	32%	68%
Manhours involved	10,800	19,200
Percentage of total	36%	64%

Thus, in terms of total written requests received, 64 percent of total manhours performed on maintenance work was on an emergency basis. Bradley pointed out that if oral requests were considered, emergency work would be an even larger percentage of the total.

The systems people also found overtime to be excessive. After examining the payroll records of the Construction and Maintenance Department personnel, they found that during the 12 months between July 1, 1958, and June 30, 1959, manhours of overtime were approximately 13 percent of total manhours worked. During this period, 23,744 manhours of overtime were worked. Assuming time and one-half was allowed, there was an expended total of 11,872 premium manhours. At an hourly rate of $2.25 (based on company records), this is an expenditure of $26,712 paid for working overtime.

The surveyors deplored the absence of records of maintenance work performed. They pointed out that the existing accounting and clerical procedures did not readily lend themselves to detailed accounting costs. They are so constructed, it was argued, that unless a special mechanical order number is assigned to a given job, there is no way of knowing the cost of individual jobs.

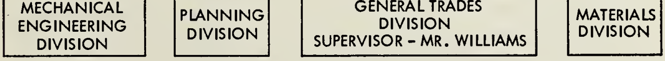
Bradley also noted that practically no preventive maintenance was being performed. Due to the lack of coordination in the department, the maintenance personnel spent most of their time on repairs requiring immediate attention. There was no time left for routine checks of equipment, or for forecasting maintenance needs beyond the day's requirements.

IV. A PLANNING DIVISION RECOMMENDED

In order to correct the above deficiencies, the surveyors recommended that a Planning Division be established within the Construction and Maintenance Department. Its principal functions would be to collect, analyze, plan, schedule, maintain records, and disseminate information as may be required by both Maintenance and Process personnel. The Planning Division would consist of a chief planner, a maintenance engineer, a cost clerk, and a clerk-typist. Exhibit 5 shows the organization of this division within the Construction and Maintenance Department. The duties and responsibilities of the chief planner and the maintenance engineer were set out as follows:

EXHIBIT 5

THE CONSTRUCTION AND MAINTENANCE DEPARTMENT



The Maintenance Engineer

The maintenance engineer will serve in a staff capacity to the manager of the Construction and Maintenance Department and to the various divisions of the Petroleum Processing Department. In this capacity, he will be assigned the responsibility of coordinating all requests for maintenance work. He will thoroughly analyze all such requests, investigate the work that has been requested, and list the manpower, materials, tools, and equipment that will be required. When necessary, he will discuss the job tickets (requests for maintenance—to be discussed later) with the craft foremen and they will arrive at a mutual manpower estimate as well as the most efficient maintenance methods. His duties will be:

I. *Duties to the Petroleum Processing Units Requesting Maintenance Work.*
  1. Collect all job tickets daily not later than 9:00 A.M. and analyze them thoroughly.
  2. Maintain an intimate familiarity with the functions, operations, and conditions of all equipment within the plant.
  3. Study constantly ways to reduce maintenance costs and improve process operations.
  4. Advise when and how equipment should be repaired with the most economical results.
  5. Observe equipment while operating and advise the process personnel of any improper operations, and recommend better methods.

II. *Duties to the Construction and Maintenance Department.*
  1. Work closely with the general trades supervisor and the craft foremen to coordinate the execution of all maintenance work.
  2. Interpret instructions to foremen when necessary, without interfering with orders or instructions already issued.
  3. Observe constantly for unsafe conditions and advise where safety precautions are required.
  4. Approve schedules for periodic repairs to equipment.
  5. Study jobs for more efficient maintenance methods and recommend same to the general trades supervisor and craft foremen.

III. *Duties to the Planning Division.*
  1. *In connection with normal maintenance.*
    a) Check the job ticket for full information and correct description of the work to be done.
    b) Check the work requested and list the crafts, materials, tools, and equipment required.
    c) Check as required with craft foremen for manhour estimate and any other pertinent information.
    d) Forward all processed job tickets to the Planning Division for planning, materials ordering, scheduling, and dispatching.
    e) Sign all completed job tickets as evidence of a satisfactory job.
  2. *In connection with emergency maintenance.*
    a) Inspect emergency jobs and render any and all possible assistance in expediting the work.
    b) If the maintenance engineer does not deem a job a true emergency, and in his opinion the job can be scheduled, he will so inform the originator and unit foreman. If they disagree, he will request further approval from the supervisor of the applicable Process Division.
    c) Collect all emergency job tickets, both for the night and day shifts. Distribute those occurring on the day shift to the Planning Department and to the craft foremen involved.

IV. *General Duties.*
  1. Request engineering assistance when necessary and assist the Engineering Department wherever possible.
  2. Study all new equipment. Make recommendations for equipment

that will be conducive to more efficient maintenance work, such as permanent platforms, monorails, and so on.

3. Recognize the importance of good housekeeping. In cooperation with the Process and Construction and Maintenance Departments, insist that cleanliness and orderliness be administered to their fullest.
4. Be constantly on the alert for unsafe practices or conditions. Insist that safety regulations be enforced.
5. Remain cognizant at all times of the importance of keeping all production units at maximum operating efficiency.
6. In thinking and planning, endeavor to devise better methods of work to reduce maintenance costs and off-stream time.

The Chief Planner

The chief planner is to be the supervisor of the Planning Division. He is to be in a staff position and report directly to the manager of the Construction and Maintenance Department. In this capacity, he will be responsible for the planning and scheduling of all maintenance work. He will also maintain records necessary to the successful execution of an efficient maintenance program. In such a capacity, his duties will be:

I. *Duties to the Planning Division.*
  1. Direct the activities of the Planning Division office and train the office personnel in their planning duties.
  2. Receive all work requests and analyze them for planning and scheduling.
  3. In supervising the Planning office, he is directly responsible for:
    a) Equipment records—their maintenance, analyzation, and other pertinent data.
    b) All planning and scheduling.
    c) The posting of labor and material costs to each individual job ticket and the analysis of such costs.
    d) Ordering of materials from the storehouse and the writing and processing of purchase requisitions for materials charged directly to jobs. Also, for the follow-up of materials that have been ordered.
    e) Maintaining ample and accurate files.
    f) Maintaining a record of manhour estimates versus actual costs of the same for the purpose of ultimately arriving at tentative manhour standards.
    g) Receiving and distributing drawings, bills of materials, and other engineering instructions.
    h) Maintaining a weekly backlog of all work.
    i) Requesting additional temporary men.
    j) Issuance of necessary reports from the Planning Division.

II. *Duties in Connection with the Daily Planning Meeting.*
  1. Conduct a daily planning meeting.
  2. At this meeting, the chief planner will:
    a) Present job tickets that must be scheduled the following day. Also, present the status of all jobs in progress.
    b) Report on the status of materials on order.
    c) Make recommendations to have work done by outside contrac-

tors, either because of the lack of manpower, or for economy reasons.

3. As chairman of the meeting, the chief planner will be responsible for having it held at a definite hour each day and within a prescribed time limit.

III. *Duties in Connection with Normal Maintenance.*

1. Analyze carefully each job ticket for correct descriptions, accounting charges, materials, tools, and equipment required. Also, note if ticket states when the equipment will be available to be worked on, and when the job is to be completed.
2. Establish priorities for all job tickets in accordance with the requested completion dates and requests from the process units.
3. Check all job tickets regularly that are being held in abeyance due to the lack of materials. To expedite such work, he will receive a notice daily from stores of all such materials which may be received.
4. Schedule at least 15 percent more work daily for each craft than the available manhours.
5. Maintain a daily list of all unassigned manpower, by crafts, and report this to the general trade supervisor, the manager of the Construction and Maintenance Department, and the manager of Manufacturing.

IV. *Duties in Connection with Equipment Records.* Analyze the equipment record cards periodically and discuss the analyses with the managers of the Construction and Maintenance and Petroleum Processing Departments, and with other interested parties.

V. *Duties in Connection with Controls.* The chief planner will be responsible for the preparation and distribution of the following reports (controls):

1. *The Daily Planning Report* which will show:
   - *a*) The number of maintenance men and manhours available.
   - *b*) The number of jobs planned and their estimated manhours.
   - *c*) The actual number of jobs worked and the actual manhours expended for normal, preventive, and emergency maintenance.
2. *The Weekly Reports* consisting of:
   - *a*) An emergency report. This will include a listing of all emergency jobs requested. It will give a brief description of the work, who requested and who approved.
   - *b*) A backlog report that shows the total manhours of maintenance and capital work, by crafts. This includes jobs not started and those interrupted. The manhours will also be converted into mandays as a more convenient control.
   - *c*) An efficiency report that shows the number of jobs completed during the week, by crafts. It will show the total estimated manhours, the actual manhours spent, and the percentage of efficiency obtained.
3. *The Monthly Reports* include:
   - *a*) A cumulative monthly planning report by days. This is the same as the daily planning report listed above, except it is cumulative by days and shows the daily trend. This will be accompanied by a monthly comparison report projecting the same information.
   - *b*) A complete listing of all outstanding job tickets for which work has not been started and/or started and interrupted. This report will show (if any) why each job is delinquent.

VI. *General Duties.*

1. Remain fully informed of the entire maintenance status at all times.

2. Serve as a liaison between Maintenance, Process, and Engineering.
3. Endeavor to devise better methods for performing work, as well as to recommend changes that will induce greater efficiency.
4. The chief planner, in all his activities, must always work and plan for the most efficient return for each manhour expended for labor, and for each dollar for material.

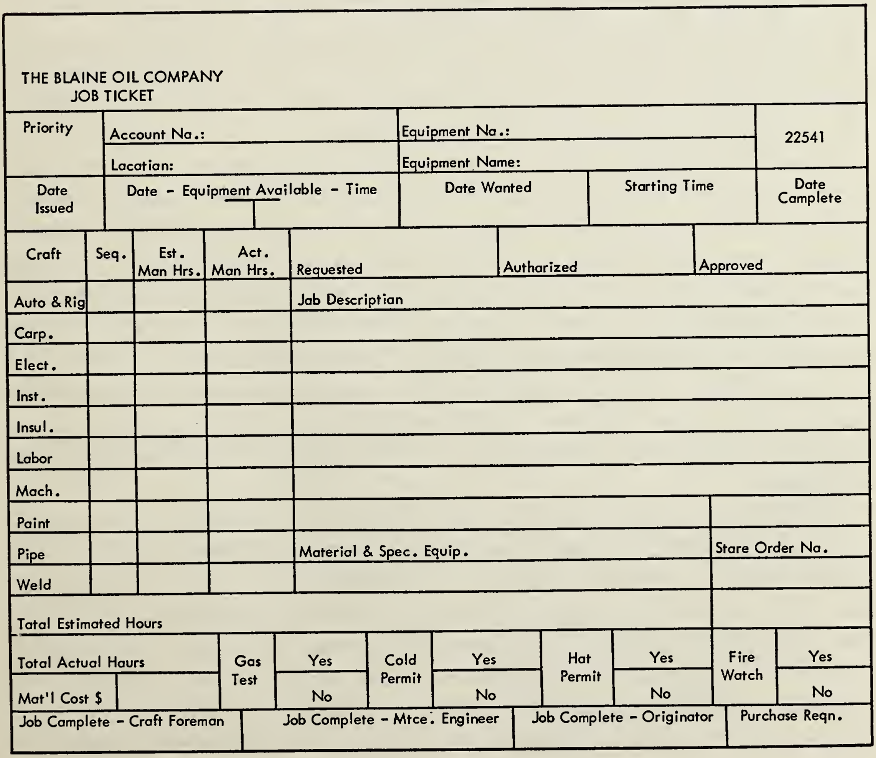
V. RECOMMENDED TOOLS FOR PLANNING

The job ticket, the daily planning schedule, and the daily time sheet are very important elements in the planning system recommended by Bradley Consultants. These three were described as follows:

The Job Ticket

The maintenance job ticket, shown in Exhibit 6, is a 5½ inch by 8½ inch form. It is a request to perform maintenance work and is originated by authorized personnel in either the Petroleum Processing or Construction and Maintenance Department. After it has been processed by the maintenance engineer and Planning Division, and scheduled, it becomes

EXHIBIT 6



THE BLAINE OIL COMPANY
JOB TICKET

Priority	Account No.:	Equipment No.:		22541
	Location:	Equipment Name:		
Date Issued	Date – Equipment Available – Time	Date Wanted	Starting Time	Date Complete

Craft	Seq.	Est. Man Hrs.	Act. Man Hrs.	Requested	Authorized	Approved
Auto & Rig				Job Description		
Carp.						
Elect.						
Inst.						
Insul.						
Labor						
Mach.						
Paint						
Pipe				Material & Spec. Equip.		Store Order No.
Weld						
Total Estimated Hours						

Total Actual Hours		Gas Test	Yes	Cold Permit	Yes	Hot Permit	Yes	Fire Watch	Yes
Mat'l Cost $			No		No		No		No

Job Complete – Craft Foreman	Job Complete – Mtce. Engineer	Job Complete – Originator	Purchase Reqn.

a work order to perform the requested work. Job tickets are serially numbered and assembled in sets of five copies each. They are distributed as follows: The first or original copy goes to the Planning Division office; the second and third copies go to the craft foreman whose men are to perform the maintenance; the fourth copy also goes to the Planning office; and the fifth copy is retained by the originator.

The job ticket originates in the unit where the equipment is located on which maintenance work is being requested. Job ticket approvals are: (1) Up to and including 50 estimated manhours, it is approved by a craft foreman or a processing supervisor. (2) From 50 to 250 estimated manhours, it must be approved by three persons: the general trades supervisor, the supervisor of the Processing Division in which the equipment is located, and a craft foreman. (3) From 250 to 1,000 estimated manhours, it must be approved by the three persons listed in (2) above, plus the manager of the Construction and Maintenance Department. (4) Over 1,000 manhours, it must be approved by the three persons listed in (2) above plus the manager of the Construction and Maintenance Department and the manager of Manufacturing.

The maintenance engineer will collect all job tickets not later than 9:00 A.M. daily. He will examine each as to proper form, and if necessary, he will return tickets to the originators for corrections. After analyzing the work requested, he adds the following information to each job ticket: (1) Materials required to perform the maintenance. (2) An estimate of the manhours needed by each craft. He may consult with the craft foreman if he desires. The maintenance engineer will then sign the job tickets and deliver them to the Planning Division.

The chief planner, upon receipt of the job tickets, requests the cost clerk to check with stores to determine if the material is available for the performance of the maintenance work requested on the tickets. Those tickets for which materials are not available are placed in a "Waiting for Materials" file. The chief planner takes the remainder of the tickets to the daily planning meeting where they are placed into schedule according to priority and manpower availability. Tickets not scheduled are filed for a subsequent day's scheduling. The job tickets scheduled are then sent, not later than 3:00 P.M., to the craft foreman whose men are to perform the work. Each foreman also receives a copy of the daily planning schedule.

Each craft foreman receives two copies of the tickets which request maintenance which involve men in their respective units. One copy is presented to the mechanic who is to perform the work. Upon completion of the work, the ticket is returned to the craft foreman involved. At the end of each day, the craft foreman will take all copies of completed job tickets and, with the originators of the tickets, inspect each job for satisfactory performance. If the work is satisfactory, both the originator and the craft foreman will sign the ticket. If the job has not been satisfactorily completed, the mechanic is recalled. After signing the ticket, the craft foreman writes in the exact work performed if it differs from the original description. It is then sent to the Planning Division for filing.

The cost clerk posts to the job tickets from the daily time sheets the manhours spent in connection with the ticket. He also posts the cost of materials used. The tickets are then filed for use in preparing reports.

The Daily Planning Schedule

The daily planning schedule is a dittoed form, 8½ inches by 14 inches, and is used to list all maintenance jobs that are scheduled for the subsequent day. Exhibit 7 shows a copy of the schedule. The schedule originates in the Planning office. Jobs to be scheduled are selected by the chief planner and maintenance engineer in accordance with requests by the originators. When completed, it shows for each job the accounting code, priority, job description, job ticket number, estimated manhours, and number of men. The schedule is to be distributed by 3:00 P.M. and represents the subsequent day's work.

EXHIBIT 7

THE BLAINE OIL COMPANY FOREMAN__________ MAINTENANCE DAILY PLANNING SCHEDULE

Date__________ Sheet____ of____ DEPT.__________

Acc't Number	Equip. Number	Priority	Job Description	Job Number	Orig. Est. Mhrs.	Scheduled Today					Total Mhrs. Spent	Complete Today	Mhrs. To Comp.	Req. Tomorrow				
						Mechs.	2nd Cl.	Helpers	Maint. Men	Hours				Mechs.	2nd Cl.	Helpers	Maint. Men	Hours

Other work performed must be considered emergency and written in on the schedule by a craft foreman. All types of work, other than emergency, appear on the schedule including work during weekends, if any. After being dittoed, a section of the schedule is detached and dittoed on the blank section of the daily time sheet. The dittoed section shows the accounting code number, priority, job description, and the job ticket number. Two copies of the daily planning schedule and one copy of the daily time sheet are given to each craft foreman not later than 3:00 P.M. each day.

It will be remembered that the craft foremen also receive two copies of job tickets which involve their unit. Upon receipt of the schedules and the job tickets, the craft foremen will plan their work for the following day. In addition, each craft foreman will, not later than 11:30 A.M., forward a marked-up copy of the current day's planning schedule to the Planning Division. The marked-up copy will show the current day's scheduled jobs that are completed or will be completed by 12:00 noon. It will also indicate the jobs estimated to be completed by the end of the day, and the estimated time to complete jobs that must be carried over into tomorrow's schedule. These marked-up copies will be used in the daily planning meeting. Incomplete or unworked jobs will ordinarily receive high priority on the subsequent day's schedule.

The Daily Time Sheet

The daily time sheet, shown in Exhibit 8, is a dittoed form 8½ inches by 14 inches. It is used by all craft foremen for reporting the time of the men under their supervision. By 3:00 P.M., each foreman receives one copy of the sheet on which are listed jobs that are scheduled the follow-

EXHIBIT 8

DAILY TIME SHEET -- MAINTENANCE DEPARTMENT

Name													
OCC. CODE													

ing day. These are the same jobs which appear on the daily planning schedule. The craft foreman posts the number of hours worked by each of his men on the "cross-hatched" side of the time sheet opposite the number of the job ticket on which they worked. Straight time is posted in the bottom right-hand section of the "cross-hatched" box. Should overtime be worked, on a time and one-half basis, the foreman will draw a diagonal line through the "cross-hatched" box and post the hours worked in the upper left-hand section. If overtime is on a double time basis, the hours worked will be circled. The craft foreman will write in emergency jobs on the time sheet and show the same information for these jobs.

Upon completion of the daily time sheet, the craft foreman will deliver it to the planning division, along with his completed job tickets, not later than 4:30 P.M. daily. The cost clerk will post the hours worked from the time sheet to the proper job tickets. The sheet is then forwarded to the Payroll Department.

VI. TYPES OF MAINTENANCE WORK

As part of the planning program, the systems people classified maintenance into three types: (1) normal maintenance, (2) emergency maintenance, and (3) preventive maintenance. The following comments were made concerning the three types:

Normal Maintenance

Normal maintenance is the usual day-to-day maintenance that can be scheduled on definite dates, while equipment is running. This type of work is charged to expense and is not classified as emergency or preventive. It is planned and scheduled as set forth above.

Preventive Maintenance

Preventive maintenance includes routine inspections, adjustments, and repairs to such items of equipment as steam traps, pumps, compressors, pressure vacuum vents, a general lubricating program, as well as stated equipment overhauls. Some work in these categories must be repeated daily or semiweekly, and so on, and is usually performed by maintenance men on long-term schedules. Its primary purpose is to prevent major breakdowns and expensive repairs.

The Planning Division in conjunction with the Maintenance and Process supervisory forces will determine the work of the preventive maintenance program. The Planning Division, by constantly analyzing job tickets, will be in a position to prepare listings of repetitive work, as well as its frequency and costs. From such an analysis, decisions can be made as to the value of placing preventive maintenance jobs on the daily planning schedule to be performed in accordance with their frequencies and the estimate for each job.

Emergency Maintenance

Emergency maintenance is work that must be performed immediately in order to prevent serious damage to equipment, cutting the flow throughout the plant, serious hazard to personnel, or serious loss of products or materials.

When emergencies occur on the evening and midnight shifts Monday through Sunday, and on the day shift on Saturdays, and holidays, the shift supervisors of the Petroleum Processing Department will originate and approve all emergency job tickets. The shift supervisors will notify the proper craft foreman who will authorize call-outs of the required craftsmen to perform the work.

When emergencies occur on the day shift Monday through Friday, they may be approved by either a craft foreman or Process Division supervisor. A job ticket for the work will be marked "emergency" and forwarded to the chief planner. The planner then contacts the proper craft foreman who will pull men from the lowest priority job to perform the work. The chief planner will also contact the maintenance engineer who will inspect the job and if, in his opinion, the job can be scheduled, he will so inform the unit foreman and process supervisor.

VII. DIFFICULTIES WITH THE PLANNING SYSTEM

The company decided to accept in total the recommendations of Bradley Consultants and institute the maintenance planning system. Bradley submitted their report on May 1, 1959. The supervisory forces were then given an opportunity to become familiar with the new procedures, and other necessary preparations were made. On September 1, 1959, the new system went into operation. Although a difficult transition period was expected, more serious problems arose than were anticipated.

It was soon discovered that the position of the maintenance engineer, Ralph Kelley, was going to be very difficult. There was also much dissatisfaction among almost all personnel concerning the paper work that was required. Also, disagreements arose concerning exactly what was and what was not an emergency. Thus, many soon concluded that the new system was not as practicable as Bradley had made it appear.

On October 1, the annual "turnaround" began in the Catalytic Cracking Division of the Petroleum Processing Department. A "turnaround" involves an overhaul of the entire installations of the Processing divisions by the maintenance personnel. Each division's installations are overhauled at different times so that all processing operations are not simultaneously ceased. Under the planning system, the work performed during the "turnaround" required job tickets which were processed exactly like other tickets requesting normal maintenance. Substantial planning, however, was required, and the maintenance engineer, the chief planner, the

Process Division supervisors, the general trades supervisor, the Process and craft foremen, and the manager of Construction and Maintenance all assisted in the preparation of the work. In accordance with the planning system, no work could be performed without a job ticket.

On the second day of the "turnaround," the planning system showed sings of an impending breakdown. Jobs were lagging behind the daily planning schedule, paper work was accumulating, and the personnel were becoming highly dissatisfied. On October 3, only 10 percent of jobs scheduled were performed. On October 4, an incident occurred which emphasized the seriousness of the problems.

Joe Baker, a highly competent instrument repairman first class, was completing a scheduled job connected with the "turnaround" in the Catalytic Cracking Division. Baker had attended Texas Tech for two years in the College of Engineering where he had done well, but family circumstances had forced him to withdraw from college, and he had sought a job with the Blaine Oil Corporation. Starting first in the yard gang, he had moved into the classification of instrument repairman's helper and after two years was made instrument repairman second class. Five years later, by reason of his mental alertness, his deft hands, and his industry, he had been made an instrument repairman first class. He had remained in this classification for two years and now was generally recognized as being the most competent instrument repairman at the Lawton Refinery.

As Baker was straightening his tools, Mr. Donald Scott, the Catalytic Cracking Division supervisor, said to him off-handedly, "Joe, see that gauge over there. It's been needing adjusting for days. See if you can fix it right quick." Joe replied that this was not on his list of things to do, but Scott insisted. About this time, Mr. Gerald Fuller, Baker's craft foreman, appeared and overheard the comments. "Go ahead, Joe, it looks like it'll only take a minute," he said.

The gauge, however, needed more than adjusting, and Baker, not being one to leave a job uncompleted, spent two hours overhauling it. About the time he had finished, Mr. Ralph Kelley, the efficient maintenance engineer, noticed him and remarked that he didn't remember this job being on the schedule. Baker said that it wasn't and explained his actions. This upset Kelley because he was convinced that the schedule must be followed.

"Joe," he said, "you know you're not to do work that is not on the schedule."

"But, Scott and Fuller told me to," Baker shot back.

"I don't care, you know the rules. Come see me if this happens again."

But Baker was a high-tempered, hard-working man. "Well, who's supposed to be my boss, anyway, you or Fuller? I can't take much more of this new planning system anyway. Why don't you just call payroll and tell them to write up my time, I'm quitting."

By this time Scott and Fuller were on the scene. Fuller pacified Baker, "Just a minute, Joe, we'll straighten this thing out, some way."

"Look, Kelley," Scott pleaded, "I told him to fix that gauge. I didn't think it would take long, and it's been needing it for days. What am I supposed to do, let my equipment rot?"

"Why didn't you write a job ticket for it?" replied Kelley.

"Hell, it takes too long to get one of those things processed," Scott shouted, and by this time he also was angry. "I've got to keep my equipment running, and when something goes wrong it needs repairing right then or time is wasted. I can't wait two weeks for a job ticket."

At that Kelley dropped the argument, but reported the incident to the manager of Construction and Maintenance, Mr. Robert Miller. Miller decided to call a meeting to discuss the new planning system and try to determine what should be done, if anything. The meeting was set for October 4, at 7:00 P.M., after hours. All supervisory personnel attended, along with the chief planner and maintenance engineer.

Mr. James Newkirk, plant manager, was chairman of the meeting. Newkirk had been with the Blaine Oil Corporation for 20 years, ever since his graduation from the Massachusetts Institute of Technology. He had been through the ranks of the technical and engineering phases of the refinery, and in 1946, when only 33 years of age, had been made refinery manager of the newly constructed Lawton Refinery. He was proud of the fact that, although the refinery had been initially constructed for a "through put" of only 20,000 barrels per day, by various means he had increased this to 35,000 barrels per day at comparatively little additional cost. Newkirk was universally admired by the employees of the refinery, by the technical men for his acknowledged competence as a process engineer, and by the rank and file because of his approachability and his interest in people and their problems.

At the meeting Newkirk related the incident and explained that the purpose of the meeting was to discover the feelings of the personnel concerning the planning system so that a decision could be arrived at concerning its future.

Paul Williams, general trades supervisor, was asked to state his views. He felt that the planning system was unworkable. His main concern was with the position of the maintenance engineer. "I hate to say this," he said, "but sometimes I don't know who's boss, me or Kelley. The men don't know who to take orders from either. My foremen tell their men to do a job one way and Kelley comes along and tells them something else. I think that the first thing that should be made clear is that Kelley either does or does not have supervisory authority."

Kelley replied that he was not supposed to have supervisory authority, but that he was responsible for efficiency. "This includes," he stated in defense, "not only making certain that job tickets are written for all maintenance work and the daily planning schedule is followed, but that the most efficient methods of maintenance are employed."

Williams agreed that the most efficient methods should be used, but he felt that he "knew about as much about how to do maintenance work as anybody."

Fuller, foreman of the Instrument craft unit, was next to give his views. He agreed with Williams and added, "There's just too much paper work now. Why, we have 5 or 6 different forms to fill out. We have to write job tickets, mark up the planning schedule, fill out the time sheet, inspect the jobs, sign the job tickets and a million other things. We spend so much time with paper work, we don't know what our men are doing."

Kelley said that he sympathized with the men and their paper work, but their problem would "take care of itself in time."

Scott, supervisor of the Catalytic Cracking Division, felt that something should be done about emergency work. "I have tried," he said, "to follow the new system, and to avoid writing emergency tickets when I can. I know that Kelley doesn't like emergency jobs and that's why I asked Joe Baker to fix that gauge without a ticket. But, I know that some of the foremen in my division as well as the others are writing emergency tickets just to get repairs that they want done, and I don't blame them. We used to be able to call on men when repairs were needed and they would do the job right then. It seems silly to me to write a job ticket for something that is going to take only 15 minutes to do."

Others were allowed to express their views, but they were merely reiterations of those already given. Then Robert Miller, manager of the Construction and Maintenance Department was asked for his comments. A mechanical engineering graduate of Oklahoma State University, Miller had been with the Blaine Oil Company for 13 years, where he began employment shortly after being released from service where he had been a maintenance engineer with the United States Air Force. For the past eight years he had been manager of the Construction and Maintenance Department.

Miller sympathized with the men and felt that some changes were needed, but that the plan, in its essentials, was workable and would eventually produce more efficiency. He agreed that job tickets might be unnecessary for work involving only a few minutes. "There are a lot of these jobs," he explained, "and maybe a supervisor of foremen should have authority to order them performed with no job ticket written."

Miller also felt that the position of the maintenance engineer should be made clear. "He is a liaison man and has no supervisory authority," said Miller, "but his advice should be respected. He should not, however, give any order that conflicts with other supervisory personnel; and, I don't think he wants to. Concerning emergency job tickets, you men know when a job is an emergency and when it isn't."

Kelley then was given another chance to speak. He was against any modification of the planning system. "If we slack off now," he said, "it will be the beginning of the end, and pretty soon we'll be back in the old groove with no organization at all. I think the truth is that the supervisory personnel just haven't gotten accustomed to planning ahead, and as soon as they do, this plan will work well."

Williams and others then expressed their belief that the system should be abandoned completely as unworkable. "We had better organization before," Williams said. Scott and Fuller felt that the plan should at least be abandoned until after the "turnaround," and then, perhaps, modified.

Mr. Newkirk then thanked the men for their help and closed the meeting.

The Tuscarora Federal Savings and Loan Association[*]

John Davis entered the Tuscarora Federal Savings and Loan Association on a hot summer Monday morning in 1961 and asked to see Jack Crowe, the chief real estate appraiser. He showed Crowe a set of plans for a 1270 square foot cement block, three-bedroom, bath and a half house that he was thinking of putting up on a 70-foot lot he owned in one of the older real estate sections of Tuscarora. Davis told Crowe that he estimated the cost of construction to be about $10,500 assuming that he contracted the job himself. He intended hiring Joseph Barnett, a bankrupt contractor, to superintend the job for a price of $600 which was included in the $10,500 price. Davis pointed out to Crowe the fact that the house was to be of quality construction with many modern design features including a built-up roof, slate floor, exposed beams and a fireplace. Crowe asked Davis just how much loan Davis expected and received the answer of $11,500. When asked why so much, Davis answered that he didn't want to attempt contracting himself unless there was some leeway in the construction money in case the cost estimates were too low. Jack Crowe looked skeptically at the plans and said, "Well, just looking at it I doubt that we could go more than $10,800 to $11,000, figuring an 80 percent loan; but we'll try to do the best we can for you." Davis replied, $11,000 is probably all right but I had hoped you could do a little better."

In filling out the loan application, John Davis gave the following facts about himself. He was 36, married, two children, and was an associate professor of political science at the university. He had lived 10 years in Tuscarora, the last four in a home which Barnett had contracted and built, but which Davis had just sold. His annual income including summer school from the university equaled $10,500 and he had an additional income of $2,500 from consulting work, writing, and lecturing. He and his wife maintained about a $2,500 balance in the Association. He gave as references, the mortgage banker who had handled the loan on the house he had just sold, the local commercial bank where he had borrowed a total of three to four thousand dollars over the last few years, a local department store, several local specialty shops, a few oil companies, and a large metropolitan department store where he was still paying on an expensive high fidelity stereo set. He had installment payments of $50 a month on his one-year-old Ford which had eight months to run and $51 on the hi-fi set which had a year to run.

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[*] Prepared by R. R. Dince, University of Georgia.

John Davis ended the interview by saying that he wanted the loan for 20 years and did not expect to pay more than 6 percent for the loan. He told Crowe that he expected the Association to make the loan because he was a depositor. Crowe assured him that the matter would be handled rapidly and presented to the board the next afternoon. Crowe said that the executive committee could not decide on the matter since both the president and the chairman of the board were absent on vacations and therefore the full board would have to pass on the matter. Davis requested quick action since he had to get out of the house in eight weeks and he had to start construction immediately. Crowe reassured him and told him to call two days later after the board had met.

The Tuscarora Federal Savings and Loan Association had $16,000,000 in assets including almost $2,000,000 in U.S. government securities. It was dominated by Michael Kent, a prominent local attorney who was the Association's chairman and whose law firm naturally handled all the Association's legal work. The president of the Association was a Mr. Hoople, a former minor political figure. There were several other executives, but their youth or the narrowness of their jobs made their influence small on the Association's loan policy. In recent years, a rival Federal association had been founded in Tuscarora. An executive of a large metropolitan association in the state had been overheard to say that if the Tuscarora Association had been doing its job and providing the volume of loan not only in Tuscarora but in the surrounding rural area, the new association would never have gotten a charter in a town of only 30,000. At that time, both associations were paying 4 percent even though many associations in the state were paying 4½ percent.

Two days later, John Davis called back and Jack Crowe told him that he had been unable to complete the loan appraisal in time for the board meeting and the matter would have to wait until next week when the board met again. Davis was quite upset about this because of the deadline for getting out of his present house. After hanging up, he called up the rival association to see if they were interested in making the loan. Since they too told him that it would be impossible to act on the loan request before next week, he decided he might as well leave the application where it was.

John Davis, during the week, was busy consulting with his architect who was slowly drawing plans for a large $30,000 house that Davis expected to put up next year on a large two-acre plot he had purchased in the best section of Tuscarora. His plan was quite simple. Considering all the delays of designing and building the house, he thought it might be a good idea to build a small house to live in putting up the small city lot he already owned as his equity. Considering the expansion of the university, Davis believed that he could easily rent the house for $115–120 a month, and as long as his total payments did not run more than $85 a month (including escrow), he would have a nice investment at little cash cost to himself. A peculiar feature of all this was that Jack Crowe had recently purchased the lot next to Davis in the expensive suburban area and had discussed building problems for the expensive area with Davis.

After a week had passed, Davis called the Association early in the morning and spoke to the office manager who told him that no decision had been made on his application. In answer to his apoplectic query as to why no decision had been made, the office manager merely said that the board had delayed its decision for another week until more information could be gathered. No information, other than this cryptic statement, could be garnered. A direct visit to Jack Crowe resulted only in an embarrassed and guarded answer to the effect that "certain difficulties had arisen, but he was trying his best to expedite the loan."

Later that day, John Davis met his lawyer accidentally. The lawyer worked in the law firm headed by Mr. Kent and did a great deal of the legal work for the Association. In Mr. Kent's continued absence, he represented Mr. Kent at the board meeting. The young attorney asked Mr. Davis to step into his office for a chat. John Davis, bristling over the continued delay in the handling of the loan, was rocked back on his heels by the attorney's frank statement that the Association's board had found Davis's credit rating to be "poor." The retail credit bureau had reported to the Association three poor items. First, he was currently slow in payment on an amount of $24 to a local department store; second, his account from an oil company had been turned over to an attorney for collection three years ago in the amount of $44; and he had not paid a bill of $6.50 to a local auto repair shop two years ago. Some six or seven other retail stores listed him as prompt and the bank also listed him as an excellent risk. The attorney said that all these items were peanuts but they had made a bad impression on Mr. Hoople who had just returned from his vacation. Davis remonstrated with the lawyer claiming that he admitted the bill to the oil company, but he could not understand the other items. He told the lawyer that in any case, he had paid in full all of these items. Besides, the bank and the metropolitan department store were the only ones which had any knowledge of his ability to handle significant debt items. He further elicited the information that no one at the credit bureau or the Association had bothered to check his record with the mortgage banker or the large city department store.

Much disturbed, John finally succeeded in worming out of his attorney friend which stores were involved. Davis pointed out that three years ago he had been flat broke as a result of trying to complete his doctoral work and the oil company had just gone unpaid. The bill was settled in full six months later even though the credit report did not show it. On calling the car agency, he found that the $6.50 item two years ago had indeed been paid, but the item had been reported to the credit bureau when the item went over 60 days. When the bill was paid, no mention of this was made to the credit bureau. Finally, Davis called up the local department store and found out that the current overdue item had been paid one day after the cycle billing date. On calling his wife, from the lawyer's office, Davis found that she had not paid the bill because she was waiting for the store to credit her with returned merchandise so that she wouldn't have to make two checks for a small bill.

John asked his attorney friend for advice. The lawyer suggested that Davis visit Mr. Hoople the next morning and explain the matter. In the meantime, the lawyer would ask the credit bureau to revise the credit report and he would also ask the banker to call Mr. Hoople directly. The lawyer felt confident that even though Mr. Kent was still absent, there was a quorum of the executive committee and a favorable decision could be reached the next day without again waiting until next week for another board meeting.

The next morning, John Davis went to the Association and asked to see Mr. Hoople. On entering the office, he almost immediately asked Mr. Hoople for an explanation of the delay in processing the mortgage. Mr. Hoople at first was evasive, saying, "There are some special circumstances concerning your loan, Mr. Davis, and only the full board can decide the matter." Since Davis knew that the executive committee could decide the matter, he refused to take this as an answer. He replied, "Listen, Mr. Hoople, if I can't have this loan decided by this afternoon, I don't want the loan at all next week. This thing has dragged on now almost two weeks and if I have to wait another five days, I never can get my house finished in time. Besides if all this delay is about the credit report, I thought that the questionable items had been explained to you. Didn't Mr. Parkinson of the First National call you about my credit rating with the bank; how about the mortgage company and the credit bureau?" Mr. Hoople said that maybe some of these people had called others in the Association but not him. He leaned across the desk and handed Davis the credit report, "You don't call that a good credit rating, do you? I've got to justify that to our examiners. Besides, look at that item from the First National Bank, it says that you are late on a payment due July 1." Mr. Davis increduously looked at the credit report in his hand and losing his temper said, "My God man, the report says *first* payment not late payment, and besides the payment was made exactly on time. You can't expect me to keep my money in this place if you can't handle the affairs of this place better than that." Mr. Hoople, a little shaken by his obvious error, said, "Well, I'll call a meeting of the executive committee this afternoon. Call me back around three."

At three that afternoon, Mr. Davis was informed that his loan application had been approved for $10,250 (75 percent of the appraised value) at a rate of 6¼ percent for a term of 15 years. Not including escrow payment, this would have meant a monthly payment of $87.75 to amortize the loan. To amortize the original loan request of $11,000 (roughly 80 percent of appraised value) would have required a monthly payment of $71.65 at 6 percent for a term of 20 years.

Plastronics, Inc.*

History of Company

Plastronics, Inc.,[1] located in a metropolitan city of the Southeast, was organized in 1946, shortly after World War II, by a small group of businessmen interested in exploiting the postwar market for aircraft parts and accessories and specialty hardware items. The original idea was to acquire surplus government property which was being sold in large quantities at that time and market such goods through wholesale and retail distribution. As the supply of surplus war goods dwindled over the next four years and other types of goods became available from private industry sources, the company shifted its operations from the former to the latter.

In 1951, the company became distributor for a line of home and commercial air-conditioning equipment. Contract work for the installation of this equipment was engaged in for several years but was discontinued in 1958, since it had not proven particularly profitable.

In the early 1950's, a customer inquiry about the possibility of using transparent sheets of acrylic plastic as an office chair floor mat (to reveal the beauty of a new floor) led to development of this line. Complementary to the floor mat, a desk top cover made from the same material was manufactured and offered to the trade. Its chief advantages over conventional plate glass desk tops were its greater resistance to breakage and resistance to etching and staining from chemicals. The company had carried acrylic plastic sheets as a distributor since the late 1940's.

During the decade of the 1950's, rapid growth, and more particularly the shift into manufacturing, placed a strain on working capital. In the early spring of 1960, W. A. Thompson, president of Plastronics, Inc., was considering a merger proposal from another corporation on a stock exchange basis. The merger would make available to the company adequate working capital but would not otherwise affect the operations, according to merger plans. Thompson, who had made an investment of $5,000 in 1946, acquired the controlling interest in Plastronics in a shifting of ownership in 1953. Approximately 125 people had been employed by the company at its peak of production.

Product Lines and Manufacturing Operations

Bill Dutton, a salesman who had had experience in plastics manufacture, began producing windshields for small pleasure boats on a part-time basis in 1953. Transparent acrylic plastic sheets for windshield manufacture were purchased from Plastronics and the windshields were distributed to boat manufacturers through Plastronics. Demand for this item developed rapidly. In 1956, Dutton sold his business to Plastronics and joined the company as a salesman. By the spring of 1960, semi-mass production under assembly line techniques had been developed. Freight on boat windshields was so high that the pattern of the industry was to locate windshield plants near the centers of boat manufacture. To serve a major customer and to expand its markets, the company opened a branch plant in another regional area in 1958.

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* Prepared by Henry Key, Texas Christian University.

[1] Names of company and persons have been disguised.

Plastics forming into lawnmower grass catchers, door-to-door salesmen's bread trays, tote boxes and small hardware trays for use in industrial plants, special trays and sinks resistant to chemical action, shells for automobile air-conditioning equipment housing, and a wide variety of similar products indicate the range and potentials of product development.

Location and Layout of Plant

The plant and home offices occupied the major portion of a one-story brick and concrete structure erected about 1930 as a municipal farmers' market. Two other noncompeting firms occupied parts of the main building. Three other smaller structures located to the rear of the site were also used by Plastronics. All buildings were leased, subject to renewals in 1960 and 1961. Lease expense was considered reasonable. The location was near the downtown area, at the intersection of a freeway and a busy thoroughfare. It also had railroad siding trackage from a major railroad. However, the only use of the railroad siding was for carlot shipment of scrap of about five carloads per year. Scrap was dumped in open coal cars for shipment.

Moving to a new location in a nearby industrial development area had been considered. This would have many advantages. A building that would suit the requirements of the company could be erected under a long-term lease. While the site would be several miles from the present location, it would be easily accessible by thoroughfares. It was believed that most employees would continue with the company if such a move were undertaken. Railroad siding trackage could be made available at the new site. Benefits flowing from a new location were considered to be: (1) a more efficient production layout, (2) greater ease and effectiveness of internal communication, (3) higher employee morale, (4) better coordination of manufacturing to warehousing operations, and (5) space for efficient expansion of plant facilities as required.

Changing Nature of Company

When Plastronics, Inc., was engaged primarily in wholesale and retail distribution of a wide line of specialty products, emphasis was placed on purchasing, where a considerable amount of "give and take" negotiation was possible. Many adaptations could be utilized to meet the competition. With the shift to manufacturing, it was recognized that the purchasing function had assumed entirely new and different proportions. Pricing policies of basic manufacturers were generally firm and well known, with little "give and take" negotiation possible. Competitive pressures could not be passed back but had to be absorbed by Plastronics through cost reduction efforts within the organization.

The change from distribution to manufacture also had an important impact on the sales function. Formerly, more than a hundred different item lines were sold to a variety of customers by as many as 20 salesmen. With the distribution lines cut in half, sales of these and manufactured products required the services of only eight salesmen. Furthermore, sales of the manufactured products were being made mostly to other manufacturers and industrial users, who were themselves highly cost conscious. Most of the sales force had been trained by Plastronics and had not experienced other types of sales effort. The decision to go "all out" in shifting the primary goal from a distribution company to a manufacturing operation was reached in 1959.

Company salesmen had been fertile sources of new ideas for products and applications. Advertising in national publications, trade magazines, and the use of direct mail brochures brought in sales leads and requests for new products. On the floor mat and desk top lines, national distribution was achieved through careful selection of manufacturers' representatives. Some export business had developed on these and other lines. Plastics manufacture is a relatively new industry, and has grown to major status since World War II. Applications seem almost limitless.

Company Goals and Personnel Policy

After graduation from a well-known engineering school, Thompson had worked for a major rubber company for about three years before entering military service in World War II. "I could have advanced to a high position in the rubber company," remarked Thompson, "but I wanted to experience the challenge of developing my own company." "The president-majority stockholder of a small, rapidly growing company is vulnerable from many directions," stated Thompson. "A small, growing company is under considerable working capital strain and cannot meet conventional credit and loan conditions except at high cost. It is not able to carry on adequate research and development to come up with patentable ideas, but must rely chiefly upon a high degree of flexibility, quick decisions, and discovery of technical know-how and manufacturing shortcuts to make money. Many people in my position have developed a quick Cadillac taste when their resources would not support it. In a company like Plastronics, a favorable image of the company demands the highest order of personal integrity on the part of everyone in the organization.

The road up is certainly filled with pitfalls," concluded Thompson.

It was Thompson's belief that the proper application of modern scientific management principles could develop Plastronics into a sound growth company by exploiting the potential market for plastic products manufacture. He was convinced that suitable orientation of individuals of the organization to the basic philosophy and goals of Plastronics would draw out and develop the potentials of the members of the organization. In 1956 a management consultant was engaged to assist in a training and development program. Goals and objectives for Plastronics, as stated in the company manual, were agreed upon as follows:

1. To be the most successful in relationship to profit potential in our industries.
2. To be the best managed company in our industries.
3. To maintain a high level of morale throughout the company.
4. To maintain a continuing but healthy rate of expansion.
5. To be the most respected company in our industries.

Company policy in regard to personnel was summed up in these statements from the company manual:

> Plastronics, Inc., is the deliberate association of a group of people desiring to accomplish something together which they either could not do at all or could not do as well by themselves. To become a successful business unit, this company must be: A competent operation, a good place to work, and a constructive participant in the broader affairs of its society.
>
> The people of Plastronics, Inc., are its greatest asset and we want to identify them as such. It is our belief that our employees have a justifiable integrity and worth in their own right.
>
> We reconcile, so far as practical, the personal desires and satisfactions of employees with the Company's aims. We strive to create circumstances which cause our people to want to produce to the maximum of their capacity in the attainment of common objectives, not because they have to, but because they want to.
>
> The incentive basis of reimbursement for as many employees as possible is an effort toward rewarding each employee according to his individual skill and the effort he expends. This means basically that Plastronics, Inc., will pay well; it means a sound promotion policy; it means provision of incentive to stimulate that still additional ounce of effort; and finally, it means recognition of accomplishment.

Standards and Industrial Engineering

Howard Grant, a young man in his early thirties, was employed in February, 1960, as industrial engineer. He had had prior industrial engineering experience with a mail order house. His assigned task was to revise the standards upon which incentive wages and costing procedures had been established in earlier years.

Engineering Associates had been employed in December, 1957, to establish standards for work operations wherever practicable in the shops.

After making studies, Engineering Associates set up rather detailed standards of the type commonly called "expected actual" for most operations and products. They were to be reviewed and revised as needed at six-month intervals. The original standards worked out very well for the first year, according to Grant, but changes in work operations and in products, especially windshields, outmoded a lot of the standards in a hurry. Application of the standards for the items then in production resulted in excessive paper work to operate the incentive wage plan and to provide cost accounting with full information. Grant decided that the plan could be simplified by grouping similar products and items and reducing the number of standards required, thus bringing the paper work into manageable proportions. This modified plan was working quite well in the spring of 1960, Grant said, but some revisions of standards were overdue.

The wage system based upon standards was a plan by which the worker was assured an hourly rate on a clock hour basis, but he could earn a bonus by accumulating allowed standard time for operations performed in excess of clock hours worked. For example, a worker who earned $1.50 per hour would be guaranteed $12 for eight clock hours of work. However, if the standard time values produced in eight clock hours amounted to nine standard hours, then he would earn a bonus of $1.50, making a daily wage of $13.50. The bonus plan was primarily effective in the boat windshield shop, but had some applicability to the Miscellaneous Fabrication Shop.

It was necessary in some instances to adjust the standards to varying levels of activity and production arrangements in order for bonus to be earned. For instance, in the operation of the heating oven for windshield manufacture, 24 heats per eight hour day could be completed, with each cycle carrying 15 blanks. However, it was not possible to achieve this rate of production if too many models of windshields were being produced because it required extra time to move out molds and replace them with other molds needed for the next models of windshields. A flexible scale of standard values for this operation was worked out to allow for lower levels of activity so that bonus could still be earned.

The labor force of the company was not unionized, and no effort had been made to organize the plant employees.

Forecasting and Budgeting

Plastronics, Inc., had been using a static approach to forecasting and budgeting. Due to the rapidly changing types and nature of products, as well as high seasonal variations, no serious effort had been made to isolate and identify fixed and variable cost elements. It was generally recognized by management, however, that rate of activity had an important impact on unit costs. The budget developed was for planning purposes primarily, with only a minor role assigned to its use as a control device, and it was not integrated with the accounting function. Statistical comparisons were made between the budget and actual financial data. "We must be careful not to move into complicated techniques too fast," stated the controller.

IBM Installation

An IBM 632 installation was acquired in May, 1959, for processing invoices. This equipment had automatic computational and punched card components tied in with the typing operation, so that various classifications of sales and cost data could be derived as a by-product. A daily sales summary report was prepared for management. Daily posting by code number to customer accounts was done on a bookkeeping machine from a list supplied by IBM. Monthly summaries by IBM supported journal entries to transfer finished goods inventories to cost of sales, and to record general ledger accounts receivable control and sales. Also, a monthly report was prepared showing gross profit by product lines and by divisions of the company. Increasing requests were coming to the IBM department for special statistical reports that were not regularly prepared. Plans were under study to place time payroll distribution on this equipment as the next application of its capabilities.

Stores Control

Engineering Associates established standards for raw materials, but the stores inventory system did not effectively control materials. For example, according to the controller, a windshield that got damaged in production could be cut into scrap and discarded without detection from the records. Revision of stores control procedures late in 1959 corrected this situation, so that from the cost reports it became possible to detect loss of a windshield blank. Daily reporting of spoiled work was instituted to aid in locating causes of high cost on production runs. Unused raw material had to be returned to stores for proper credit to production costs under the new system. Also, if spoiled units had salvage value, the work-in-process was credited for the salvage value and the material placed back in stores. Prior to 1959, no systematic plan of giving credit for salvage value had been attempted.

Materials were being priced on a weighted moving average basis under a Kardex perpetual inventory control system. Prices of most raw materials had remained fairly stable over the past few years, although occasionally high freight costs were incurred on special shipments. Sometimes bargain purchases of raw materials were possible from sources that were discontinuing items.

Shortage of working capital caused the company to maintain very tight control over inventories of principal raw material items. Scheduling of delivery was timed so that a new shipment was sometimes due to arrive on the day that stock on hand was scheduled to be placed into production, according to Marvin Lee, purchasing agent.

Cost Accounting Procedures

Windshield Plant. The boat windshield shop was located in a long sheet-iron building immediately back of the main building. Near the center it had a 90-degree change of direction and ended at street level on a side street. A truck could enter the building at this end to pick up finished products.

Flat sheets of transparent acrylic plastic in various sizes and thicknesses constitute the principal raw material for making boat windshields. It has been used almost exclusively for small pleasure boat windshields because: (1) the material can be easily worked, (2) molds and patterns for forming and shaping are less costly than would be true for glass, (3) it can be routed around an overlay pattern to remove excess material and leave smooth edges, (4) holes can be easily drilled for screws, bolts, and attachments, and (5) while sheet acrylic plastic as a raw material is more costly than glass, the relatively short production runs make tooling for glass windshields prohibitive. Despite the comparative ease with which the material can be worked, a considerable amount of technical know-how is required for efficient production of a quality product.

Production scheduling centered around a four-point plan: (1) sawing and forming, (2) routing, (3) chrome frame application, and (4) wrapping for shipment or storage. Full-scale production in the windshield shop required a work force of 24 people, at which level from 350 to 400 units per day could be turned out, stated Nelson Fuller, shop foreman. With a crew half this size, about 150 units a day could be produced. Fuller, about 30 years of age, had been with the company two years.

The cutting of acrylic sheets was a critical operation. If the saw did not have the proper sharpness and temper, or was run at the wrong speed, the material chipped, from which a crack might develop, spoiling the blank. It was also easily scratched and had to be handled with care. Windshield blanks were cut from the large sheets, washed and dried, and then passed into the heating oven for softening. From the oven the hot pliable blanks were clamped on molds and allowed to cool. The molded windshields were next routed to cut away excess material and holes were drilled as needed. From the router operation, the windshield was passed to the buffing station for polishing and removal of minor scratches. At the next station, chrome aluminum channeling to form the holding frame of the windshield, and to furnish decorative finish, was cut and shaped to the windshield configuration. Beyond the chrome bending station, the trim and windshield were assembled. At the final station, the windshield was cleaned and packaged for shipment or storage. A kit of attachment hardware was also made up and packed with the windshield.

Prior to late 1959, the costing procedure for boat windshields had been by job order. With growth of the number and variety of windshield models, this system of costing became overburdened with voluminous paper work. Unit costs derived were not fully comparable because of frequent changes in work arrangements and because time charges often were improperly made to the various jobs. Many operations took such a short time to accomplish that the paper work involved in recording them required more time than the operations. The time lag in getting out cost reports under this system made the reports practically useless to management from a cost control standpoint.

In October, 1959, a certified public accounting firm was engaged to make a cost study. After November 1, 1959, the costing was changed to the process basis computed monthly using average cost per windshield as the unit. Although many different types and styles of windshields were produced in a month, it was believed that the average unit cost produced was a more useful figure than unit costs derived under the old job order system. Actual costs were accumulated by cost elements on a weekly scheduling basis, with monthly summary by cost elements. At the end of the month, production was also costed at standard. Journalization for monthly posting was symbolized by the following entry:

Dr: Finished Goods (at standard)
Dr/Cr: Variance
  Cr: Work-in-Process (at actual cost)

Systematic analysis of the variance to reconcile with the ledger variance account was not attempted. However, perusal of the production records for the month to pick out major causes of variance was followed, and a report submitted to management. This practice seemed to furnish sufficient information for management, according to Jim Carter, chief of cost accounting. When standards were established in 1957, a factor for general and administrative expense was not included in total manufacturing cost. In the revision of 1959, general and administrative expense was included in production costs.

On windshields direct labor costs were accumulated in three categories: (1) regular hourly clock rate wages, (2) incentive bonus for standard time allowances above clock hour time, and (3) overtime premium at one and one-half times the regular clock hour rate for hours over 40 in each week. Overtime premium was not paid on the basis of more than eight clock hours on a daily basis. Total direct labor costs for the month were derived from (1), (2), and (3) above and applied as productive labor under the process cost system.

After direct labor, burden was charged to each job on the basis of direct labor cost at predetermined rates. The cost of direct labor was a relatively minor part of the cost of a windshield.

Constant effort was being made to discover cost savings possibilities, commented Fuller, foreman of the Windshield plant. An instance of cost saving was the substitution of metal fasteners to hold the windshield in the chrome channeling frame. Previously rubber gasket channeling and a sealant similar to that used for automobile windshields had been applied. The metal clips could be installed in a fraction of the time needed to mount the windshield with rubber channeling.

The practice of frequent model changes in small boats created serious problems of retention and storage of molds and patterns. Some windshields were not basically changed in a subsequent year, the styling of the trim being the only change. A troublesome problem was related to production of repair and replacement windshields for earlier year models. Production of one unit for replacement on an older boat was very costly, and usually not profitable. Judgment was used in making some replacement units for stock to reduce the cost per windshield on these replacement runs.

Revenue of significant amount from sale of scrap was credited to cost of sales.

Miscellaneous Fabrication Shop. Windshields were originally manufactured in the job shop located in the basement of the main building, but when volume reached the point that the area could no longer accommodate all the factory production, windshield manufacturing was moved out. All other production was retained in the original shop, which became known as the Miscellaneous Fabrication Shop. Located below street level, there was no room for future expansion of the basement area.

Dawson, foreman of the shop, had 10 employees at work late in the spring of 1960. At capacity about 22 people were employed in this shop. A variety of machines and equipment was required for the types of production done in the Miscellaneous Fabrication Shop. The labor force had to be rather versatile, but no particular difficulty had been encountered in hiring men as needed. Dawson stated that he began studying everything he could find on the plastics industry as soon as he went to work for Plastronics some 10 years ago.

Among the items being manufactured in the Miscellaneous Fabrication Shop, the more important were dry boxes (for the electronics industry, scientific apparatus manufacture and industrial uses, where atmospheric conditions and temperature range had to be controlled closely), office chair floor mats and desk tops, housing shells for automobile air-conditioners, grass catchers for lawnmowers, bread trays used by door-to-door salesmen, tote boxes and small hardware and tool trays for industrial use, windows and "bubbles" for aircraft, and a variety of plastics products for household and commercial usage. Plastics products were manufactured by both the die forming and the vacuum forming processes, depending on the nature of the product.

The "dry box" was a cabinet constructed of flat and formed pieces of transparent acrylic sheets assembled into a box with apertures through which a worker could insert the hands and forearms into special rubber gloves for working on miniaturized transistors and similar parts within the box (inside of which atmospheric pressure, cleanliness, humidity, and temperature were carefully controlled).

Airplane windows represented a rather specialized manufacturing operation. Two formed pieces of acrylic sheets (clear or tinted) were sealed together around the edges, leaving a void or space inside. The air trapped in this space had to be exhausted and a special gas used to fill the space, to prevent clouding and distortion of vision in the window. The "double glass" window formed an excellent nonconductor against heat or cold from outside the cabin of an airplane. Formerly, a large quantity of "bubbles" or convex windows used in aircraft were manufactured but this business had dwindled to a fraction of its former volume. Also, "honeycomb" paneling had been produced for a large aircraft manufacturer but had been suspended temporarily in the spring of 1960. Paneling of similar construction but made from plastic "honeycomb" and flat acrylic sheets or formica was under experimental development for commercial and industrial applications. It was very light weight, unusually strong, and soundproof.

Dawson said that his predecessor had tried to keep too many things in his head. He believed in keeping good records and using them.

In the Miscellaneous Fabrication Shop, direct labor cost consisted of all clock hour wage costs on a job. If incentive bonus were also earned on a particular job, it was charged to the job on which it was earned as direct labor cost. As to overtime premium for work in excess of 40 hours per week, those jobs on which the actual overtime premium was incurred were charged. The explanation given for this procedure by Carter, chief of cost accounting, was that the shop capacity was loaded on a first in, first out basis, and orders that came in late which overloaded the plant should bear the overtime premium cost which they caused.

If a rush job not scheduled for production in the first 40 hours of the week were accepted and turned out within the first 40 hours, this job was charged for any overtime premium it may have caused on regularly scheduled jobs.

On stock items and repeat business, a job order for the quantity desired was set up. Actual costs were accumulated by cost elements for the job until completion. The completed job was then costed at standard also, if standards had been set. The following journalization at the end of the month typified the recording of jobs completed during the month:

Dr: Finished Goods (at standard)
Dr/Cr: Variance
  Cr: Work-in-process (at actual)

If a special job that had not been produced before was being quoted, a cost estimate was worked out jointly by Herb Dawson, foreman of the Miscellaneous Fabrication Shop, and Howard Grant, industrial engineer.

Actual costs were accumulated on the special job. Journalization of completed jobs was as follows:

Dr: Finished Goods (actual)
  Cr: Work-in-process (actual)

Financial Data

Following are financial data and statements pertinent to the company's operations during the past five years:

EXHIBIT 1

PLASTRONICS, INC.
Comparative Operating Results for Fiscal Years Ending October 31

	1955	*1956*	*1957*	*1958*
Sales (net)	$2,284,865	$2,706,515	$2,934,515	$3,595,960
Commissions earned	8,210	11,395	16,860	17,645
Total Income	2,293,075	2,717,910	2,951,375	3,613,605
Cost of goods sold	1,828,845	1,924,715	2,161,740	2,454,355
Gross Profit	464,230	793,195	789,635	1,159,250
Less: Operating expenses	444,745	676,885	668,870	837,360
Net	19,485	116,310	120,765	321,890
Less: Other expenses	1,515	8,880	8,015	21,995
Operating profit	17,970	107,430	112,750	299,895
Less: Bad debt allowance	580	55,825	18,330	144,135
Settlement of federal government claims			41,085	
Inventory adjustments				61,620
Total deductions	580	55,825	59,415	205,755
Net operating profit	17,390	51,605	53,335	94,140
Less: Profit sharing dividend			1,390	26,435
Reserve for federal income tax*			9,645	29,410
	...	...	11,035	55,845
Net profit	$ 17,390	$ 51,605	$ 42,300	$ 38,295
Investment (net)	$ 192,455	$ 181,475	$ 172,565	$ 181,730

* Not shown for 1955 and 1956 because of loss carry-over which canceled out entire tax liability in each of these years.

EXHIBIT 2

PLASTRONICS, INC.
Balance Sheet October 1, 1959

ASSETS

Current assets			
Cash		$ 13,605	
Customer notes and receivables	$320,425		
Other receivables	21,040		
Total notes	$341,465		
Less: Allowance for doubtful accounts	44,040	297,425	
Inventories		447,470	
Prepaid supplies and services		20,385	
Unamortized manufacturing and tooling expense		21,985	
Estimated refund on prior year's federal income tax		31,860	
Total Current Assets			$832,730

EXHIBIT 2—*Continued*

	Cost	*Accumulated Depreciation*	
Operating property			
Furniture and fixtures	$ 49,235	$ 28,780	
Machinery and equipment	64,285	27,060	
Autos and trucks	9,545	3,680	
Leasehold improvements	40,225	20,870	
Total Operating Properties	$163,290	$ 80,390	82,900
Intangible assets			
Trademarks and goodwill			410
Other assets			
Deposits and cash value of life insurance		11,020	
Deferred research and development costs		5,470	16,490
Total Assets			$932,530
LIABILITIES AND NET WORTH			
Current liabilities			
Notes payable—Bank, secured	$117,100		
Notes payable—Other	5,800	$122,900	
Accounts payable—Trade and other		539,765	
Accrued expenses payable		5,270	
Accrued and withheld taxes payable		20,210	
Employee deductions—Savings and profit sharing		760	
Total Current Liabilities			$688,905
Long-term note payable			9,690
Deferred credits to income			3,710
Net worth			
Capital stock—Authorized 100,000 shares—$5 par, issued 40,000 shares of which 10,000 are in treasury; 30,000 shares reserved for stock purchase warrants	$200,000		
Paid-in surplus	72,835		
Total contributed capital		$272,835	
Retained earnings (Exhibit 4)		11,820	
Total net worth		$284,655	
Less: Cost of treasury shares		54,430	
Net worth			230,225
Total Liabilities and Net Worth			$932,530

EXHIBIT 3

PLASTRONICS, INC.

Statement of Income and Expense for Year Ended October 31, 1959

Sales		
Resale items		$1,347,720
Manufactured items		2,024,575
Total sales—net		$3,372,295
Cost of sales		
Resale items	$1,066,235	
Manufactured items	1,375,300	2,441,535
Gross margin on sales		$ 930,760
Other sales related income		11,890
Gross profit		$ 942,650
Operating expenses		
Sales, distribution, and general administration		947,710

EXHIBIT 3—*Continued*

Loss from operations			$ 5,060
Other expenses			
Sales discount	$ 16,620		
Interest, loss on assets scrapped, life insurance premium, and other	19,225	35,845	
Other income			
Purchase discounts	760		
Interest, rents, sale of assets, and miscellaneous	15,570	16,330	
Excess of other expense over other income			19,515
Net loss for year			$24,575

EXHIBIT 4

PLASTRONICS, INC.
Statement of Income and Expense for Year Ended October 31, 1959

Balance, October 31, 1958		$66,505
Add: Estimated federal income tax refund from loss carry-back		31,860
Total		$98,365
Deduct: Inventory adjustment as of October 31, 1598	$54,470	
Cash dividends	7,500	
Net loss for year ended October 31, 1959	24,575	86,545
Balance, October 31, 1959		$11,820

EXHIBIT 5

PLASTRONICS, INC.
Summary Statement of Cost of Goods Manufactured
for Year Ended October 31, 1959

Work-in-process, October 31, 1958		$ 21,330
Manufacturing costs incurred		
Raw materials used	$928,760	
Direct labor	151,600	
Burden applied	345,490	
Normal manufacturing costs incurred	$1,425,850	
Add: Underapplied burden	37,020	
Total manufacturing costs incurred		$1,462,870
Work-in-process and manufacturing costs incurred		$1,484,200
Less: Work-in-process, October 31, 1959		10,010
Cost of goods manufactured for year ended October 31, 1959		$1,474,190

Adams-Baldridge Co.[*]

During the summer of 1961 a professor was teaching an executive development program to a group of men from the building industry. During lunch one of his former students, Al Adams, Jr.,[1] who was sitting next to him, said, "Professor, you talk now, as you did several years ago, about the universality of management principles; and if a manager knows them and knows how to use them, he can be a good manager regardless of what industry he enters. That's just not true. It may be for other industries but not for the building industry. We are at the mercy of the government and those who finance construction. For instance, right now we are in a rough spot because there is no money for building. How can you be a good manager if your customers don't buy? If we could just lick this problem we would have it made."

Subsequently, the professor was retained as a consultant to make a study of the overall operations of the company. Here are results of his findings.

Business Activities

The Adams-Baldridge Co. is located in one of the highly industrialized cities in the South. The company, which is engaged in the wholesale distribution of building material and industrial supplies, carries a full line of building materials used by residential and commercial contractors, except brick and lumber. The company carries only a limited line of industrial supplies.

The organization sells to contractors, retailers, other jobbers, institutions, industrial plants, and those organizations that have their own maintenance personnel. However, they do not sell to the home owners themselves.

History of the Organization

In the early 1920's, Mr. Al Adams had successfully established himself in the contracting business. In the course of his activities, he had been able to establish contacts with manufacturers and various other sources that enabled him to secure materials at an advantageous price. Therefore, he attempted to start a jobbing business in connection with, and in addition to, his contracting business.

During the middle of the 1920's another man, Mr. Dan Drake, joined the firm as a partner. Still later in the decade, Mr. Bob Baldridge came to the company from another state where he had obtained experience in the contracting business. His function was to supervise the office work of the rapidly expanding business. By the end of the 1920's, the wholesaling and distribution end of the business had become so promising that the owners decided to withdraw from the contracting business so that they could devote their full time and energies to the wholesaling activities and at the same time not compete with their own customers.

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[*] Prepared by Leon C. Megginson, Louisiana State University.

[1] All names have been disguised.

Therefore, the owners incorporated in the early 1930's as the Adams-Baldridge Company. The new business was to engage in the distribution of such items as hardware, mouldings, insulating materials, roofing, and so forth. They were to serve as jobbers, or as wholesale dealers, in these supplies, materials, and accessories.

Mr. Adams was elected president; Mr. Drake, vice-president; and Mr. Baldridge, secretary-treasurer. The three of them were the only stockholders and also constituted the board of directors.

Although the new business started on a limited scale, it advanced rapidly and its sales grew steadily so that by the late 1930's a new building was constructed on one of the main traffic arteries of the city by Mr. Adams. The building was then leased to the company and is still occupied by it.

In the early 1940's Mr. Drake died and his shares of stock were acquired from his estate by Mr. Adams. Shortly thereafter, some of the stock was sold to Mr. Carl Chance who was then elected vice-president. Prior to that time Mr. Chance had been a salesman for the company and was considered a very promising and fast-rising young man.

During World War II the company, as was true of so many of its counterparts, had a real struggle for survival because of the shortage of materials and labor. However, because of the hard work of Messrs. Adams, Baldridge, and Chance and a few of the employees who were able to stay with the company, it was able to survive, and even operate profitably.

Since World War II, the company has grown very rapidly so that it is now one of the leaders in its field in the area that it serves. During recent years a greater degree of emphasis has been given to selling to industrial concerns, institutions, and public utilities.

Around 1955, Mr. Al Adams, Jr., graduated from college with a B.S. degree in business administration. He joined the firm shortly thereafter and assumed the title, manager of sales. He is now a member of the board of directors. Mr. Baldridge's son resigned a regular commission in the armed forces in order to return to the company as assistant secretary-treasurer because of the failing health of his father. He also serves as a member of the board.

The capitalization of the company is now around $300,000. At the present time the Adams family owns 51 percent of the stock, the Baldridge family 33 percent, and the Chance family 16 percent. The corporation is a closed corporation, and the ownership and control is closely held by the three families.

Organization

Mr. Adams, who is president and general manager of the corporation, is the patriarch of the organization. He is, at present, semiretired, as he puts it, is making way for Al, Jr., to take over the business. "Al, Jr. is gradually working me out of a job by taking over my duties." He is in surprisingly good health, considering his age (mid eighties). During his early days he was a master craftsman but later gave more emphasis to the sales aspect of the business. He was very adept at meeting people, making contacts, making estimates on jobs, and buying and selling. During the early years of the corporation, he ran the selling and warehousing phases of the jobbing business.

Mr. Adams has been characterized as a very likable person who has become very conservative in his later years; who will listen to any reasonable problem, and if you can justify your position, he will grant the request. During his more active days in the business, he had a great deal of business acumen as far as buying and selling were concerned. This asset, coupled with aggressiveness and energy, made him one of the leaders in the business. However, he did not participate very actively in the other aspects of the business. He would rather sell on credit and carry it for a period of time than have the customer discount it in advance. Also, rather than buy merchandise frequently and in small quantities to keep inventory costs down, he would buy in large quantities. During his active periods of participation, people would hurry when he called them, and when they asked him a question his first statement to them was "Why?" Mr. Adams married Mr. Baldridge's sister, but she died without children. He has since remarried and has one son and one daughter, both of whom are married, and have children. He is still president and general manager and handles some of the details of the business although this is decreasing markedly. As one executive put it, "He still has one of the best minds in the business. It is a shame his body isn't 30 years younger." He is still a member of professional and civic organizations, but not very active.

Mr. Baldridge is secretary-treasurer of the organization, and is also credit manager. As is characteristic of so many people in his position and at his age (mid seventies), he tends to be frugal in the operations of the business. He also had a great amount of business judgment, as far as the financial aspects of the business are concerned, but had little interest (or knowledge) of the other operations. In this respect the two men complement each other excellently. This blending of characteristics helped make the business as profitable as it has been. His experience has caused him to be so conservative in the granting of credit that it is possible that sales may be hampered at times because of the tight credit policy. During his earlier days he had rather strong convictions and once he made up his mind, he would not bend; but he has tended to become more tolerant with age. His decisions are almost always 100 percent correct, "according to the book," but in practice, this is not always true. The reason for the discrepancy is that often his decisions will be too conservative and restrictive. The delineation of the business into the front office and the warehouse and the back office has tended to have an adverse effect over the years. Often he will complain about the back office being "overstocked" in inventory while he is constantly trying to get enough money to run the business. Often this is true, but sometimes it is only apparent. As one executive put it, "It is the old story of the salesman wanting to make the sale regardless and the credit manager wanting to hold down credit losses."

In performing the duties as credit manager, he has a set, automatic procedure—at the end of 30 days and 60 days a letter goes out indicating that the account is 30, or 60, days overdue. According to him, credit is a set of figures on the book, not personalities. However, he will give every consideration to a customer who is having a bad time, if he will only come in and talk the problem over with him. As indicated, although he is 100 percent correct according to theory, sometimes he appears to be otherwise. However, he has an exceptionally low debt loss.

Although he has a bad heart, he still works every day. He still worries about the business and has little, or limited, outside interests or hobbies. Although he is active in civic, professional, and religious activities, he has no physical hobbies such as fishing or social clubs. He came from a big family, and his mother died when he was young. He has had to earn his own living since then. As far as mathematics is concerned, he has a brilliant mind. His forte is strictly financial affairs and he has not concerned himself with the purchasing or selling activities during the last 30 years. He has a son and a daughter, both of whom are married and have children. It was said by one member of the organization that he would probably die if he had to retire from the business. He is still responsible for the "front office."[2]

Mr. Carl Chance is vice-president of the company. In addition he is responsible for sales and purchasing. Mr. Chance was employed by the company in the late 1930's in a sales capacity. He had been in and out of the contracting and jobbing business before that time. Mr. Chance became a stockholder of the company in 1940, at which time he was made vice-president and a member of the board. He is around 50 years of age and has been divorced, but remarried several years ago. He has two grown sons, one of whom attends college and the other one works for another company in another industry. His duties at Adams-Baldridge include all the buying for the company. In this capacity, he contacts the various salesmen from the suppliers and actually places the purchases. In addition he is responsible for all the sales in spite of the title of Al, Jr. All the salesmen operate under him and report to him. He is also responsible for buying all materials for the company, both building materials and industrial sales and purchasing; and this is his first love. He is in charge of the warehouse and "back office."

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[2] In essence the operations and physical setup of the business are composed of three separate units. The "front office" is comprised of the main office and showroom of the business. It faces on the main street and is readily accessible to anyone entering the premises. Here, the financial aspects of the business are conducted. Cash sales are made and the money received, the goods that are sold on account are billed, the payments for goods are received, credit is approved, the materials bought from suppliers are paid for, and the other financial arrangements are conducted in this part of the business.

The "back office" is composed of another office in the rear of the warehouse. Here, the sales, the purchasing of materials, and related activities are carried on.

The third part is the warehouse where the goods are received and stored. Here deliveries are made to cash customers and shipped to others. About 10 years ago, when the second office was added, through tacit agreement between the partners, Mr. Adams began to run the "back office" and warehouse and Mr. Baldridge runs the "front office." As Mr. Adams assumed less responsibility in the actual running of the business, Mr. Chance began running the "back office," including the warehouse.

It is hard to form a clear image of Mr. Chance. He has been characterized many ways by the employees. One person said, "He is one of the hardest working men in the world." Another one said, "He never *asks* you to do anything; he *commands* you to do it. Even if he doesn't have direct authority over you, he assumes that he does." This tendency has grown over the years so that the employees are afraid of him. Another one said, "He has a multitude of duties and does them well." However, it can be said that he has a strong dynamic personality and is very capable in performing the duties that he has assumed over the years. He has almost a total lack of patience with employees. His lack of long-range planning, coupled with the apparent inability to delegate authority and responsibility, has resulted in his becoming involved with too many details that could be handled by subordinates. He is unpredictable in that one never knows whether he will greet him with a cheery smile or with a cold stare. A disproportionate amount of his time is spent on the telephone, even to the extent of not talking to the people who are in his office.

Many of the employees give him credit for developing the company's position in the industrial market and for helping develop the rest of the business to the point where it currently is. In many respects he is even given credit for the present profitability of the company.

From comments he made, the consultant got the feeling that he wanted to increase his influence over the organization by upgrading the industrial sales and his own control over selling and buying while minimizing the status of the other activities. When asked what was the main problem of the business he answered, "Red tape!"

Mr. Chance is one of the first men there in the morning, but is also one of the first to leave in the evening. He spends a great deal of his time entertaining the industrial purchasers during the evening.[3] He is a member of various social clubs, including the country club, and various professional organizations.

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[3] In this industry the industrial buyers must be entertained lavishly. As one of the members of the organization said, "You almost have to buy their business with entertainment and gifts." However, even then, after you have bought the entree, you still must have the lowest competitive price to get the business.

Mr. Bob Baldridge, Jr., the assistant secretary-treasurer and assistant credit manager, is in his late thirties, married, and has two children. His education was rather varied in that he began in engineering but because of difficulty with mathematics switched over to another field of study. He then started the business administration curriculum but discovered that he liked psychology best so took his electives and degree in that field, with a minor in English. He tends to be philosophical and introspective but not to any degree that would be detrimental to his managerial abilities. He feels a lack of background in business training and education. Because of a series of circumstances, including his military service in two conflicts, he did not marry until he was in his thirties.

As a boy he used to work around the business in the warehouse. He entered service during World War II and became an officer in the Air Force. Following the war he returned to the company for two years; but because of the frustrations associated with working in a position where he had no authority or responsibility and to prevent a personality conflict, he returned to the Air Force to make it a career. In 1955, upon the advice of his family and of his father's doctor, he resigned his commission and returned to the business to perform some of the duties previously performed by his father. It was with reluctance that he returned, but because of his sense of duty to his father and to the business, he did. Nine months prior to this time he married and now has two children. Although he was promised, either explicitly or implicitly, that he would assume his father's duties, until the present time he has not because the older man is still performing them.

He is very active in numerous outside activities, including civic clubs, his church, professional organizations, alumni association, fraternal group, and his college social fraternity.

In spite of his weakness in higher math, he is level-headed and apparently a good manager. According to the president he is "A very excellent man. He is stable, level-headed, and has a keen analytical mind." From observation, he appears to be relatively easygoing and according to one of his subordinates, "He has never exhibited temper or lack of emotional control."

As he sees his job, it is to assist his father in performing the financial activities of the company, including granting of credit. In addition, considerable time is devoted to giving oral and written quotations to the governmental institutions who call or write for price quotations. He also assists architects, designers, contractors, and owners with the selection and specification of their materials and supplies and maintains contacts with builders to try to build up the trade of the business. Although he has many ideas for the improvement of the company, the press of other duties and the lack of authority has prevented him from carrying them out.

Mr. Al Adams, Jr., is the manager of sales. The position he holds in the company is very nebulous and intangible. He is the president's only son and, as the president indicated, he is being groomed to take over his position; and although he is currently sowing some wild oats, it is expected that he will soon settle down, take an interest in the business operations and management, and become proficient in it.

In his late twenties, he is married and has one daughter. After graduating from college with a degree in business administration, he entered the Army immediately following the end of the Korean conflict. Although admittedly smart, he is still easygoing and happy-go-lucky and tends to be a practical joker and engaged in a lot of horseplay in and around the business. Everyone gives him credit for being smart and having great interest in a new project. However, he is frequently not able (or willing) to follow through to completion of the activity.

Because the company buys from such a large number of manufacturers in so many parts of the country, it is necessary to have one person responsible for making price changes in the company's sales catalogue. The changes are so frequent and of such magnitude and variability that the profit of the company is dependent upon keeping accurate selling figures. This responsibility has been turned over to Al, Jr. He does not particularly like it and tends to let the work get behind for as much as a month at a time.

He is socially minded and belongs to various social clubs, including the country club. In addition, he belongs to a civic club, and a couple of professional organizations.

These five men constitute the management of the organization. They are the board of directors and the primary executives. The board meets formally only once a year and could be classed as inoperative. During recent years, staff meetings were attempted but did not prove successful for some member of management seemed to always find it necessary to be away during the meeting. This has led to an apparent lack of coordination in the organization. There is a very poor and ill-defined channel of command. Many of the individuals interviewed said they were not clear as to the authority-responsibility relationships. Often, one of the executives in one place will hear about something the others have done through the grapevine.

There are 36 employees in the firm, in addition to the five executives. There are 11 in the front office, 13 in the back office, and 12 in the warehouse.

Mr. Baldridge and Bob Baldridge, Jr., have desks in the front office. Mr. Adams has a private office in the front office which is used for a conference room when he is not there.

Mr. Chance has a private office in the back office and Al, Jr., has a desk there.

Personnel Policies

The Adams-Baldridge Company has fairly good personnel policies. They pay competitive wages with the result that they have low turnover in most positions. It is felt that in some instances the capacities of the personnel, either inherently or because of inadequate education, training, or experience, are at too low a level with the result that there is some "dead heading." There has been a periodic turnover in the billing clerk, file clerk, and secretary's position, although at the time of the study it was stable. The organization does operate under the Federal Fair Labor Standards Act; and although it does not have to pay the minimum wage to all of its employees, it does so as a matter of policy. The company is not unionized but has made no effort to keep unions out.

Paid vacations are granted to employees, and there is a very liberal sick leave policy. There are no minimum time periods for coverage under the vacation and sick leave policies. The only people excluded are the temporary employees, which included periodic extra day laborers who are hired on a day-to-day basis and "Kelly girls" who are utilized in the offices only at periodic intervals as the need may arise.

There is a liberal major medical provision that includes hospitalization and surgical benefits as well as a life insurance program. The cost is $1 per month for a single person and $2 for a married person. For all practical purposes the company pays the entire cost.

Summary of Findings

First of all it must be emphasized that the company has been very profitable, although at the time of the study they were suffering from a reduction in sales. According to one executive, "We are barely meeting the break-even point in our operations. All we need to do is increase our sales. The rest will take care of itself."

The company appears to be two separate businesses within one, with the front office being one separate domain and the warehouse and back office being another. The invisible dividing line leads to most of the difficulties.

There is no apparent chain of command, with the result that there are assumed chains of command. This leads to the difficulty of different people performing the same activity while other activities are not being performed by anyone.

Also, there is a need for a cost accounting system to see which phases of the business are profitable. It is felt that the industrial business, although high in volume, is low in profits because of a highly competitive market and services that must be performed for these buyers. According to another manager, "The business we do is in large volume, but these are our 'bread and butter' items that carry a low profit. Our specialty items carry a large profit, but our volume is low on them." According to one member of the board, "The sales (of our other items) are high but the profit is low. Also, some of our country salesmen don't pay their way because they are in a highly competitive field where they must give discounts and yet their expenses are very high."

Another weakness is the fact that the salesmen are on a straight salary. Something should be done to provide for some form of incentive system such as a low basic salary with a commission superimposed upon it.

Another weakness that is felt by some of the people is that certain of the personnel are highly inefficient with some of them not having enough to do with the result that they are "dead heading" while the others have too much to do. This may be a function of paying low salaries in certain cases. In some few jobs the wage is too low, although competitive, or the caliber of personnel is low. As previously mentioned, the turnover rate among the billing clerks, file clerks, and phone girls has been periodic, whereas the turnover among other personnel is exceedingly low.

Other inefficiencies in the operation are the slowness in billing which takes from three to five days. (If this could be speeded up, the posting could be done quicker and eliminate the need for some of the duplication in activities such as keeping double lists of the delinquent accounts.) Another deficiency is the number of errors that are made in the work, particularly by the billing machine operators. Part of this can be attributed to the obsolete machines that are being used. Some of the records also seem to be unnecessary.

The physical facilities, particularly in the offices, are totally inadequate. There are no private offices except for the president and vice-president. Also, the offices are too crowded as well as being separated and too noisy.

The Southern Corporation[*]

The Southern Corporation, nationally known manufacturers of printed business forms, has several production plants located in various parts of the United States. One (Midwest Division; see Exhibit 1) is located in a Southern town of Terryville—the locale of the present situation. Another (Eastern Division) is located in the East at Gott; others are located in various parts of the United States; the home office and the Central Division plant are in Wheatville.

Ted Sawyer, a former industrial engineer and Harvard MBA graduate, now the manager of the Terryville plant, has an internal organization and human relations problem which he has seen develop from the time the Terryville plant was built three years ago. An internal dispute has arisen as to who is to perform an inventory control function necessary to the plant's efficient operation.

Ted has been approached by a college professor of management, a young man of about the same age as Ted (35–40), to write the problem as a case study. Ted agreed to let the professor interview him along with the other members of his managerial staff who were affected by the problem. The interviews which the professor made were approved, in advance, by Ted, but each person was not acquainted with what others had said. Of course, the interviews have been edited to some degree for repetitions.

The cast of people involved, in order of names mentioned, is as follows:

Ted Sawyer, plant manager in Terryville.
Jed Katz, plant superintendent at Terryville.
Mr. Appelman, executive vice-president at Wheatville.
Rod Teller, supervisor of purchases for Terryville.
Don Harvey, production control supervisor at Terryville.
Sam Overton, office supervisor at Terryville.
Bill Collins, supervisor of collating, boxing, and shipping department.

The relationship of each of these men is shown on the organizational chart of the Midwest Division, located at Terryville. The other plants are a bit larger than the Midwest Division, which employs about 200 people.

The conversations concerning the "disputed function" are presented in dialogue form.

TED: I have here the file which gives the history of the situation. The Midwest Division organization was set up three years ago. The Southern Corporation officials coming to the ground-breaking ceremonies here in Terryville

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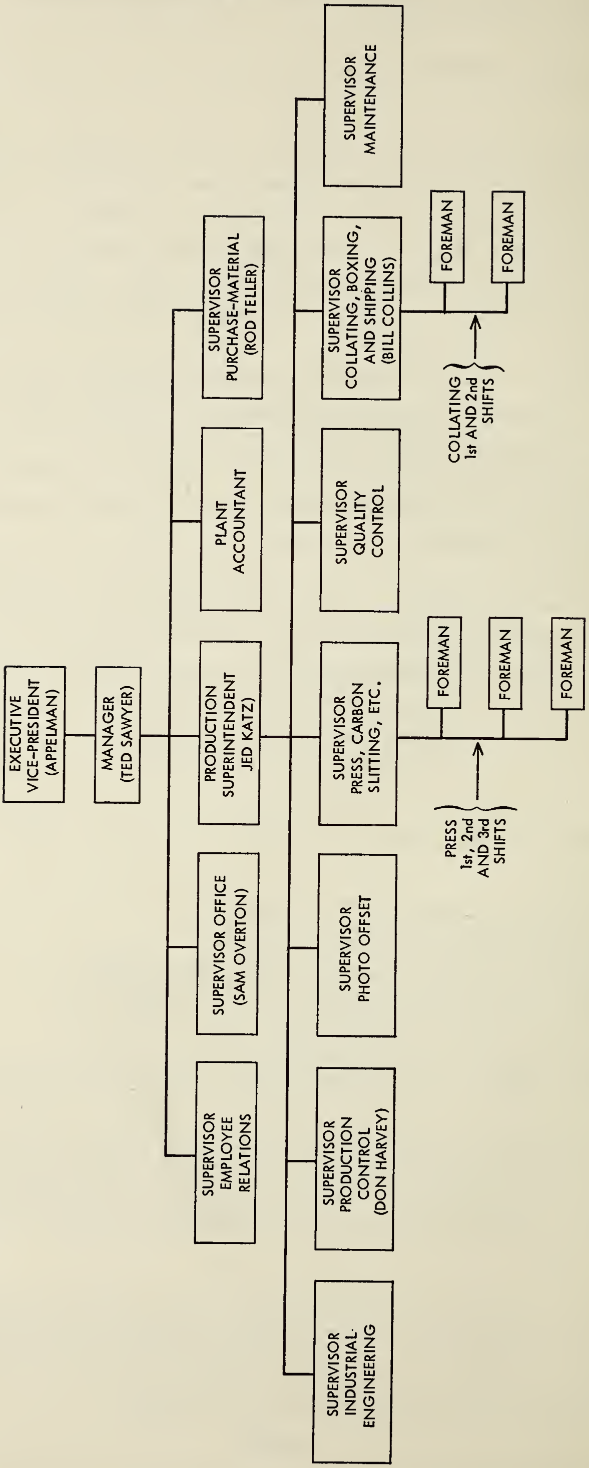
[*] Prepared by Robert D. Hay, University of Arkansas.

EXHIBIT 1

Midwest Division


EXECUTIVE VICE-PRESIDENT (APPELMAN)
MANAGER (TED SAWYER)
SUPERVISOR EMPLOYEE RELATIONS
SUPERVISOR OFFICE (SAM OVERTON)
PRODUCTION SUPERINTENDENT JED KATZ
PLANT ACCOUNTANT
SUPERVISOR PURCHASE-MATERIAL (ROD TELLER)
SUPERVISOR INDUSTRIAL ENGINEERING
SUPERVISOR PRODUCTION CONTROL (DON HARVEY)
SUPERVISOR PHOTO OFFSET
SUPERVISOR PRESS, CARBON SLITTING, ETC.
SUPERVISOR QUALITY CONTROL
SUPERVISOR COLLATING, BOXING, AND SHIPPING (BILL COLLINS)
SUPERVISOR MAINTENANCE
FOREMAN
FOREMAN
FOREMAN
PRESS 1st, 2nd AND 3rd SHIFTS
FOREMAN
FOREMAN
COLLATING 1st AND 2nd SHIFTS

were the top executives plus Jed Katz, production superintendent, and me. Jed knew that he was going to be the superintendent of the plant, but I had never been officially told that I was to be the plant manager. This was officially announced at the banquet after the ceremonies.

When we went back to the main office in Wheatville, I immediately sat down with the executive vice president, Mr. Appelman, and we began planning the organization. In setting up the organization, we at that time had, and still do have, certain functional heads in the company. There were finance (a treasurer was over that function); vice president, manufacturing; vice president, marketing; director of purchases and materials; and director of employee relations.

With respect to acquiring people, I went to each of the functional vice presidents and said, "I want your recommendation for someone for this position." And I had to define what each of these jobs was. For example, we had a purchasing and receiving function—I wanted a man over that. The vice presidents had their recommendations—to some extent they were holding off to discuss them with me.

Before the Midwest Division was organized, we had set up our Eastern Division at Gott 7 years ago. The Midwest Division plant physically is the same size, square foot per square foot, except that the office here is twice as large. We expect to double the plant capacity so the office will be ready for that. So the organization should be the same.

Professor: Is it?

Ted: Yes, it is about identical. There are a few differences; we are coming to one of them.

Professor: Do you have a policy on decentralization of functions?

Ted: Yes.

Professor: Decentralization is definitely there in the production function?

Ted: Yes.

Professor: How about the selling function?

Ted: We have a different setup there. Our vice president of marketing at the moment has 9 divisions under him—9 divisional managers and these divisions are not in any way related to production. Or let me put it another way. For some of the orders we produce, certain sales divisions feed all their orders to the Midwest Division. These sales divisions are built on a territorial basis. For example, we have a sales representative in Terryville. I have nothing to do with him at all. He reports to his district manager in St. Louis, and he reports to the Northwest Divisional manager in Lincoln, Nebraska.

Professor: What sales area do you service? How many sales areas send orders to you to produce?

Ted: About 3 or 4, I would say. We do almost all the work for St. Paul, Minnesota. The orders that are channeled to us are in the Midwest belt from north to south. When an order comes in, it goes to Wheatville. There are several plants where that order could be produced.

Professor: Wheatville is production planning, so to speak?

Ted: Yes.

Professor: What do they call this function?

Ted: They call it order scheduling. They make the decision where it is going to be produced.

Professor: Do they take all the orders from the Midwest and send them here to the Midwest Division?

Ted: Yes, unless they have a special reason to do otherwise. In fact, in some cases the decision has to be made by a committee before the order can be taken from Dallas and manufactured in Gott. The Midwest Division physically cannot produce some of the features on forms that the customers want. There might be a customer in Terryville who wants a certain feature on a form, and the only place we can do it is in San Francisco, California. So we send it there. But 90–95% of our production is performed on sales from the Midwest belt.

PROFESSOR: Ted, what about this stock form problem?

TED: Suppose our sales representative in the field goes out to a customer's place of business. And a customer says a number of things. "Our perpetual inventory records on this particular form are all out of whack, and we didn't get the order to you soon enough. I know you can't possibly produce them, but give us some blanks the same size for a while." The salesman says, "I can do that. I've got some stock forms on which we can guarantee 24-hour delivery." He sends us a telegram or he calls us on the phone and says, "Midwest, send me 5 cartons of 801 single." And they're sitting back there in storage. We pick them up and put them on the conveyor, and out they go. Or the customer might say, "I'm doing a lot of tabulating work, and for that we use certain blank forms, ruled, etc. I'm running out. Get me 20 more cartons."

Now, who should be responsible for doing this work in the plant? Let's take the flow. The sales representative sends an order directly to our plant.

PROFESSOR: This order does not pass through central order scheduling?

TED: No. Because these are "stock" forms, and all we do is watch our inventory. These are not tailor-made for the customers.

PROFESSOR: So you've got a deviation in procedure? You're saying that when you get an order for a standard stock form, the order does not go through the central scheduling coordinating body.

TED: That's right. Now, I'll tell you why. Because we keep it in inventory here. We have to keep the inventory up to a certain point—our low limit. We do that ourselves and we're responsible locally to keep the inventory up. We watch the sales and we're guided accordingly.

PROFESSOR: How do you know what level to keep?

TED: We started off by guessing, and we learned by experience.

PROFESSOR: Who performs this function?

TED: Now you're getting into our problem. In the Central Division, the man in charge of purchases and materials has a function under him called Materials Control.

PROFESSOR: This is not included under production control?

TED: No. It has nothing to do with production control. As a controller of raw material inventory planning and scheduling, this man gets the sales order from the field—that is, the inventory clerk. And when a sales order comes in, and they want 5 cartons of 801 singles, he goes to the ledger, he writes it down, and he subtracts it and puts down what's left, and he then drops his paper in the mail and it goes out to the shipping department. The shipper puts the cartons on the conveyor, puts it on the truck, and ships it.

PROFESSOR: Is that what happens here in the Midwest Division?

TED: Different people do it here. First, let me mention the Eastern Division.

Now the manager of the Eastern Division has under him a purchasing agent and an office supervisor and a plant superintendent, etc.—same as we have. As they began getting the orders direct, and as they set up some of their front-end operations, they evolved a job that they call the supervisor of the preparatory division—getting everything ready. They now have 2 superintendents. One takes the flow from this point to that, and then another takes over. The sales order has to come in the mailing room anyway. Why should we send it over to purchasing and have some clerk handle it up there—it's just another step. Why not put that inventory clerk in the mailing room or in the office right where the mail comes in? This clerk opens up the order, does his paper work in the ledger, and mails it back to shipping.

Professor: He becomes a subordinate of the office supervisor?

Ted: Yes. There's one other thing that is done. A label has to be made for that carton—to denote which customer it is going to. In the Eastern Division this person is right in the office where the label is typed. They simplified the flow of work by putting in the office that person who was watching the low limits and keeping the perpetual records, and they took it away from the man responsible for purchasing.

So when I was setting up my organization to come down here, I had to decide what I wanted my men to do. I didn't know enough, for example, in the financial end of it. I didn't know exactly what this accountant or controller did. I got the job descriptions out of the men who were doing those jobs. I visited the Eastern Division right off the bat and got the job descriptions of those men working for the manager. I had those in the back of my mind. From that I evolved what I felt were the responsibilities of each of these men. One of the functions that was questionable was inventory control. While I was working on that, the production superintendent (Katz) came to me and said, "I would like to have the stock form control under my production control supervisor." He (Katz) had also been to Gott, and he was living in Wheatville, so he knew how it was done.

Now I don't know where he got that idea. I think he got it from our production control supervisor who wanted to do it. I'll tell you why I think this happened. The inventory clerk in purchasing, when he got to a low limit of 100 cartons, had to issue an order to tell the production division to restock that item. So he initiated an order to tell the production division, "When you get a chance, work this order in among your tailor-made orders. Don't disturb the deliveries to customers, but work this order in and replenish the stock." Now our production control supervisor, who, I think, had this idea originally, was on the receiving end of those orders. Secondly, he had had the experience of being the materials requisition clerk. He requisitioned everything else for the tailor-made orders. He had to make sure that the paper was ready, that the right amount was computed, that the ink was ready, that the carbon was ready. So he was familiar, if you will, with requisitioning material.

So this problem comes up. The production superintendent says to me, "I've got some ideas on how to handle stock forms." I said, "Well, have you talked it over with our buyer?" Now, by this time we had the people selected and named—Rod Teller was the man who came down here as buyer, the purchasing man; Katz was the superintendent. "Have you talked it over with him?" "Well, no." "Well," I said, "get together with him and see what you come up with, and then let's get together and discuss it."

The next time that I heard anything about it, the superintendent said to me, "We are ready to discuss it with you." As I recall, we had that meeting in Wheatville. These two men met with me and they agreed. Teller said, "I'm willing to try it." In other words, I'm willing to let the production control people handle the ledger.

Professor: In other words, Teller gave this function to production control.

Ted: Yes. We have a job description for these men—a position analysis. In the position analysis it says that Teller will be responsible for control of inventory. I said, "Rod, you're willing to try this?" He said, "Yes, I am." I said, "Jed, you understand the problem here is coordination, communication, and so forth?" I said, "Now, what about the director of purchases and materials? He assumes that this function is being handled by Teller." We left it that way generally.

We moved down here and right off the bat Teller gets a communication from the functional head of purchasing. And Teller says, "Hey, who's going to answer this letter?" So I call a meeting and I say, "Look, if we go back and tell the home office that we are doing this differently, we may not be allowed to continue it." After all, I had not ever released the responsibility from the buyer. He still had the responsibility. Officially, we were set up that way, but unofficially we said, "Let's play around a little bit. I'll take that chance. I'm willing as long as everybody in the Midwest Division plays the game properly. Let's try out this theory that everybody appears to have that this is a better way of doing it than what's being done in either the Central Division or the Eastern Division—it's a third way."

Professor: So the Eastern Division was handling the stock form control function in the office; the Midwest Division, in the production control; and the Central Division, in purchasing.

Ted: Right. And, traditionally, the purchasing man has had this responsibility. This was done for the past 37 years at the Central Division.

Professor: You mentioned that you did not want the home office director of purchasing to know about your experiment. Why not?

Ted: I had a lot of other things in my relationship with the director of purchases and materials that were far more important to me.

It's not a major problem. I had other problems such as the salary I was going to pay Teller. I wanted him to take Teller off his job and start training him, and he had a different approach than I had. I didn't want to come and say as a new manager, "I'm going to take away some of the responsibilities that you think this man is going to have." And here's Teller, a young fellow—Katz is older and much more experienced. He (Katz) may have overwhelmed Teller. Teller wanted to cooperate. He wanted to be one of the gang. All of these things are factors. So my appraisal of the situation was that it's not too serious. We can't go too far wrong. I can keep my eye on it, so let's try it. After all, maybe we've got something here. As long as we're together as a group, as long as we play the game with each other fairly and squarely, as long as we keep the responsibility where it's supposed to be officially with Teller, the buyer, we can't lose anything. So, communications-wise, we've never said anything to the home office, and I don't think they know it yet. I don't know, but all the communications back and forth and discussions are between Teller and the director of purchasing.

Professor: All reports go from Teller to the home office purchasing?

Ted: That's right.

Professor: Do you get a coordination copy of Teller's reports and the home office replies?

Ted: Yes, I do. When I see that everything is okay, I throw them away. I'm being kept informed. That's all.

Professor: What do you think of this?

Ted: It's just that I've got functions under me that are similar to our corporate functions. It's coordination. That's all it is.

Professor: You're still responsible for purchasing at your plant and if anything goes wrong, you get the bee put on you?

Ted: Yes.

Professor: How about Teller? Does he get orders from the director of purchasing?

Ted: This is an interesting subject to explore some day. The men who came down here thought that I was their boss on paper only. After all, you take my office manager's relation to his boss. He'd worked under him for years and years. His boss to him was the big guy in the home office, and sure I'm manager, but then his job is office management and he'll get his orders from the corporate office manager. Katz was the same way on manufacturing. Also, we had some other problems.

Now, I haven't gotten into the reasons why production control thought this was worthwhile, or why they convinced Teller they should have it to begin with. Things went on for a while. Then the problem began. Well, let's put it this way. By nature I didn't want to leave this thing unresolved. It's my responsibility. I didn't want to leave this thing up in the air because it's not good management, and it leads to problems. And we've got a problem as a result of it. So I have let it go on for a year. I said to myself, "Surely in a year we've got enough experience to know whether we should do it." So I called a meeting.

We have in our company a program called Management Development. After the appraisal, after the inventory of supervisory potentials, we tell each man certain things he needs to improve on to help him. We'll give him short range position objectives. Now this is also an everyday working tool. It isn't just to develop the man, but it's part of getting jobs done, too. So I gave short range objectives to my production superintendent, and the production control supervisor, and the buyer, Teller. I said, "We've been doing this for a while now and I'd like your recommendation as to whether we should continue the way we're doing it." I was using the MD program, as I call it. These fellows knew what was coming. They knew that I wanted to bring these things to a head.

Well, peculiarly enough, Katz came in to say that he should continue to have it; and Teller came in saying that he wanted it back.

PROFESSOR: How about the office manager?

TED: I remembered when I got these two recommendations that the Eastern Division doesn't involve either of these two men. So I called a meeting at that point. I had the production superintendent draw on the flow chart the present method. Now this flow, of course, shows that it comes in through the office supervisor. So when I got to that point, I had an excuse or a reason, if you will, logically to bring in my office supervisor because he's in the flow. We sat down and I said let's discuss the problem.

Here I had in a position analysis that purchasing was responsible for that function, yet purchasing had abdicated the function. He had released it and had given it to production control, but I had never communicated through the superintendent. I always communicated through my buyer. Well, that's the problem right there. I go to him; he goes to the superintendent, the superintendent goes to production control—this is ridiculous. After all, we're all within 50 feet of each other.

But actually the buyer felt the job wasn't being done as well as it should be. He couldn't get to the man to improve. He's going right past Katz. Katz's going to say, "I'll take over from here."

PROFESSOR: Teller was violating proper channels of communication by going direct to Harvey?

TED: Oh, yes. We take it seriously. Well, Harvey says, "I'm not going to do it. Get out of here. Don't bother me; I'm running this thing." Teller's got the responsibility, but he can't do anything about it—no authority.

So, Teller came to me before I asked for these two recommendations. Teller is the kind of person—he doesn't want to criticize his fellow man. We preach teamwork so much sometimes that we don't get things done because we want to be nice to the other guy. As smoothly as he could he said, "Harvey's not doing his job." And he said it very well, but it's very obvious that Teller wants that function back under him, and he wants me to take it away from

Harvey and give it to him, or he wants me to pave the way. But his approach is, "Look, this is good for the division." He doesn't even talk about Harvey and so forth. He says, "You know we've had a couple of items here where we've run out. Or, I think we've got too much inventory. I think we have too much money tied up in inventory."

Now, let's go back to the beginning. When I said okay originally, I said to Katz, "One reason for not having it in your hands is you won't give a hoot about inventory. You just want it there. If you run out of work on tailor-make on a certain press, what's to prevent you from just putting stock forms on that press? Who's going to watch the money aspect of this inventory?"

And he says, "I'm a responsible guy. I won't do that." And he is; he does watch.

What I'm saying is that if I had to bet one way or another, I wouldn't bet on my production man to be inventory control conscious. This is the advantage of having the function with purchasing because purchasing wants to keep inventory down. Maximum turnover.

Well, Teller came to me and talked about a few of these things. I said, "Now look. You're responsible for giving away this job, and I talked very frankly to him. I used that as an opportunity to point out that he was new at the game and was a young fellow. He started at Wheatville when he didn't know what it was all about, and he wanted the job and so forth and so on. He gave up something that was his responsibility.

He said to me, "I still think there are some advantages of having it under production control." I said, "All right, what you should do then is do as much as you can up to the point where you're stuck and I'm not going to do a thing. I'm not going to move one finger to help you. See?" Now, in a sense I was doing two things. One was that I was training him. That's part of this whole picture. I can't duck out and say it's strictly a functional thing. I was using this to train this man to help develop him. But the second thing is very true. He did abdicate the job. He was at that time asking me to give it back to him. He wanted me to pave the way for him, and I said, "I won't pave the way for you. See what you can do on your own." He said okay, and we kidded each other back and forth. I was very friendly to him, but he walked out, I'm sure, feeling that he had gone a little too far in so easily wanting to cooperate.

He came back to me again and said, "I think that for the good of the Midwest Division, we ought to. . . ." He had some good examples, if you will. I had this other compelling reason; it wasn't fair to him in the first place, and secondly, it's not good management to let a thing like this go on. So, I asked him and Katz for their recommendations. They came in diametrically opposite. So, I've got the problem to solve.

My office manager made it very evident that he thought he could do it better than anybody else. He didn't say so in so many words, but he pointed out that his counterpart in the Eastern Division had this responsibility, and his work was efficient, etc. Okay, so I called a meeting, and this meeting was one year ago.

I wrote a memo to each of them that the following factors have been indicated as having a bearing on the situation. I'm listing them below for you to study prior to our meeting, and I said there will be a meeting. Please be prepared to discuss your viewpoints and any others that will help to solve the problem.

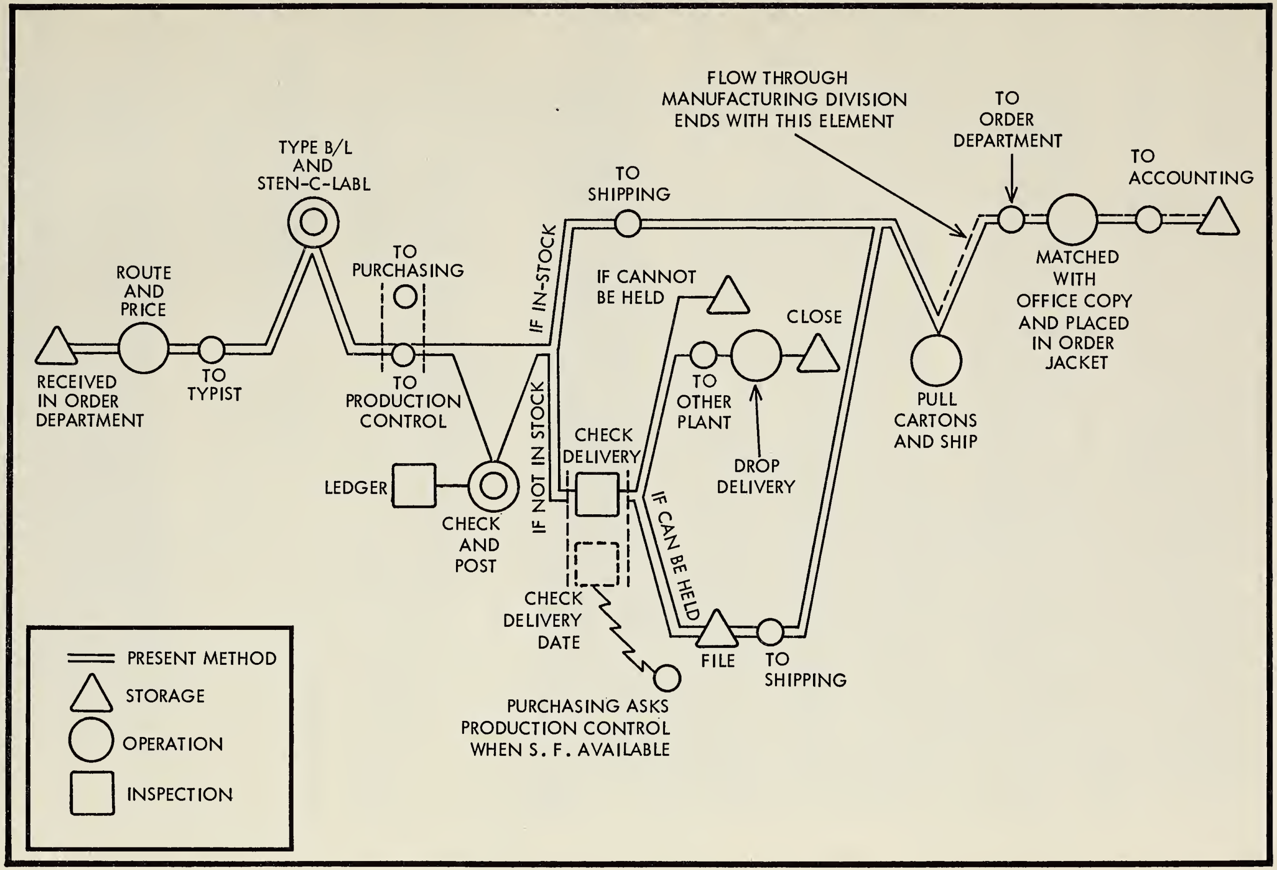
Professor: Ted, why have you waited for a year to take any action?

Ted: Well, I've been sitting on this problem, hoping it would work out.

Professor: You had a meeting one year ago this February and didn't get very far. Have any other things happened in the meantime?

EXHIBIT 2

Process Chart
Stock Form Orders, Midwest Division



TED: The next action was in August of last year. This was a letter from Teller to me, copy to Harvey. He said that Don Harvey and he have recently completed a review on stock forms, and they recommend that the following ones that are attached here be dropped from our inventory.

Well, of course, leading up to this letter was the discussion that he had had with me during this time. I told him to go back and grab hold of this responsibility.

PROFESSOR: Why do you think Teller wanted the job returned to him?

TED: Teller wants it back because it is in his job description. He's responsible for it, and yet he can't do anything about it. He hasn't the authority because he's given it to someone else. He agreed to that.

PROFESSOR: Why couldn't he revise his job description and put the function in Harvey's description?

TED: I think Teller feels he can do a better job than Harvey from the standpoint of inventory control because he handles all the paper control and the control of all other stock items. It is a stock item as far as he's concerned, and incidentally, it's being done this way in the Central Division.

Now, however, I don't think we've gone into the reasons why Harvey and Katz feel that they should have it in production control. In scheduling the presses they could keep the presses busy a maximum amount of time, so to speak, by working in these replenishment items for stock.

PROFESSOR: In other words, it's a matter of flexibility and convenience to production control?

TED: That's right.

PROFESSOR: And in Teller's case, it's a matter of his having the responsibility?

TED: Yes. And secondly, he does try to control inventory and to minimize cost of carrying inventory and yet have a respectable balance on hand to meet the customer's demands.

EXHIBIT 3

MANAGEMENT POSITION ANALYSIS FOR BUYER

Buyer
Position Title

Midwest Division
Division-Dept.-Section-Location

Terryville

Part I. *Position Description.*

A. General Objective of Position. Responsible to Midwest Division Manager for procuring, storing, and issuing equipment, materials, and supplies.

B. Responsibilities and Authority.

1. Personnel and Organization. Approves the selection, termination, training, promotion, and classification changes of all personnel directly and indirectly under his supervision within the limitations of Company policy. Approves compensation for nonexempt personnel and recommends to the Division Manager compensation for exempt personnel under his supervision. Recommends changes in the organizational structure.

Total under supervision ____________. Directly supervises ____________.

2. Operational. Compiles, recommends, and operates within the approved Budget for his division.

EXHIBIT 3—*Continued*

Consults with supervision to develop improved materials and supplies.
Supervises Purchasing, Receiving, Stores, and Material Control.
Recommends to superior; executes all approved policies for his division.
Develops and maintains sources of supply.
Assists Financial Division in periodic physical inventories of assets.
Cooperates with Corporate staff personnel on Corporate programs and policies which affect his division.
Makes decisions and advises superior on all matters concerning his division in emergency situations when superior is out of town.
Performs all other duties as assigned by superior.

C. Relationships.

1. Within the Company. Serves on all intra-plant committees as assigned by superior.
   Requests and considers advice from the Director of Purchases and Materials or other Home Office personnel.
   Consults, advises, and informs the Division Manager, Division heads and Department supervision about price changes, availability of materials, inventories, and waste.
   Represents his division on any inter-plant committees as appointed by superior.
   Communicates with employees under his supervision according to Company consultative management practices.
2. Outside the Company. Acts in the best interest of the Company in the furtherance of good public and community relations.
   When necessary, represents the Company and Midwest Division in meetings with customers, potential customers, salesmen, or other individuals and groups.
   Maintains cooperative relationship with suppliers and other industrial purchasing personnel.

D. Results Expected and Measurement of Performance.

1. Operate his division according to and within the financial budget.
2. Maintain harmonious relationship between management and employees.
3. Maintain adequate inventory of correct materials to meet production schedules. (Item in dispute)
4. Procure quality materials commensurate with price and requirements.
5. Maintain good relations with suppliers.
6. Maintain correct inventory records.
7. Develop subordinates to maximum effectiveness.

Measurement.

1. Regular budget reports.
2. Production loss due to employee unrest and poor morale.
3. Number of late deliveries, scrap due to substitutions, value of inventory.
4. Manufacturing material costs, customer's complaints.
5. Comments through conversation of Plant Manager with salesmen and officers of Company suppliers.
6. Accuracy and timeliness of records.
7. Number of subordinates performing effectively and ready for promotion.

E. Comments.

Prepared by __________ Date ____ Other Approvals:

Approved by __________ Date ____ ______________________ Date ____
(Immediate Superior)
______________________ Date ____

Professor: Have you ever run out of stock forms?

Ted: Yes, but not too often.

Now, there's one position we haven't talked about—Overton, the office manager. Let's look at the flow chart. Overton is our first contact with the customer. If there's any question about stock form specifications, Overton handles it. However, if it's a problem of delivery dates, Harvey handles it.

Professor: Suppose that the order is not shipped. Who makes sure that the order is shipped on time?

Ted: Well, right at the present time, production control would do that because he's the one who has it in the ledger. He's the one who releases it to the factory and so forth. This responsibility has never appeared in writing, and this is the main reason why Teller came to me in the first place. He said, "By golly, we shipped an order 5 days late last month—a stock form order," and he went on to tell me all the details of the story, and the essence of it was that Harvey wasn't paying much attention to when we got the orders out. By golly, if he had the responsibility, he was going to see that we got it out on time.

Professor: But the customer still has to contact Overton?

Ted: No. Production control is the one who contacts the man in the field on a question of delivery.

Professor: But, on specifications? Who?

Ted: Any specifications, any changes, anything other than delivery, Overton is the one. It's a clerical job except the orders have to flow through him because he does add value to it, so to speak. He types the bill of lading and the stencil label. In other words, he does some work on the orders that has to be done before the orders are shipped.

Professor: Now what you're thinking about is to transfer Harvey to the office manager?

Ted: Here is Harvey who has been handling delivery questions and Overton who handles everything else. Why not get the two men together who completely communicate with our field? Secondly, we must also take on the planning and the analyzing of orders before we schedule, and this is logically office work. The Eastern Division has a former office manager who takes the orders from the beginning right to the point where they are released for the type to be set.

Professor: If that's the case, how are you going to make sure that the inventory is controlled?

Ted: That's the only thing I have to be concerned about. Every month I get a report of the dollars of stock forms in inventory. So without looking at any one item, I know that we've got so many thousands of dollars worth of inventory in stock forms. Now as long as that stays within $5 to $10 thousand either way, I'm not going to worry about it. The fellows take it a little more seriously. They see an item with 10 cartons out and we haven't shipped one in a year's time, so maybe those 10 cartons are worth $200 or $300. Why not keep them. Well, maybe it saves us 5 square feet of floor space. That may not be a big problem; it depends on how conscientious you want to be. So I'm concerned more with speed and seeing that things are being handled properly than with maintaining a certain minimum or maximum dollar value of inventory in stock. My main concern is speed and efficiency in handling orders; therefore, it follows logically that these should be the people concerned with handling the problem.

Professor: From what I know about control, I would think that production control would have first claim on this function, especially on stock forms in the inventory.

Ted: I agree with you except production control in our company is under the factory superintendent—the production superintendent. It's dangerous to have that line man, that production man, control inventory and also be responsible for production. The tendency is for him to say I don't want any machine ever to go down; therefore, I'll keep my inventory up.

Professor: So you want to put a check on the production man?

Ted: Yes, sir. That's the reason I didn't want it in production control in the first place.

Professor: How does the office manager get into the act?

Ted: He's right in the line. When an order comes in, he checks the price. He's just as much a production foreman or supervisor on getting these orders right as the man on the floor who's putting on the right color of ink. He makes sure that the copy is right so that the guy that sets the type can understand the copy; and he schedules it, then he tells the salesman, "You can have it."

Professor: The uncertainty of who should handle the function is probably causing a lot of uneasiness among the 3 men. Do you think that once the matter is straightened out, that things will operate better?

Ted: Yes.

Professor: In other words, things operate better if there is a clarification of authority and responsibility than if there is not?

Ted: Definitely.

Professor: Why do you want to put this function under Overton?

Ted: First, we will group the sales effort. Very frankly, Harvey and Overton don't get along very well because the sales functions are split. Overton will get a telephone call, and he's buddy buddy with all these men in the field. They'll say, "Hey, you've got to move the date up a week." Now if Overton does a good job, he'll say, "I'll turn you over to Harvey." But he's more inclined to say, and I would be too, "Sure I'll move it up a week." But he comes over and tells Harvey, and Harvey says it can't be done. Or Harvey is talking to a salesman about a delivery date, and the salesman says, "Incidentally, I want you to change that specification." And Harvey comes and tells me. In other words, these two fellows do not work under the same department head, so to speak. So that's the first reason for making the move.

The second reason for making the move is that physically when you move around the office, all of this logically can go under one man. Why should I have Katz, who's my production man, walking back into all these office clerical jobs. It isn't going to add one thing to the improvement of the work. Much better if all of the clerical people are under one man. Now that's the second basic reason—flexibility and adaptability.

The third reason is the work load on Katz. I don't know whether he wants to admit it or not, but he has got his hands full. Katz now has 8 men reporting to him. I've been somewhat critical of the job he has done in the last 4 or 5 months.

Professor: You mean his span of supervision is too big?

Ted: I think his span of supervision is too big. Katz right now, you see, has about 120 people under him; Overton has 10. Not saying that Katz can't handle 120 people; but as we grow, it's just a major job; and he is not spending enough time out on the factory floor.

Professor: Well, that's enough for now. Let me talk with Harvey.

Don Harvey is 40 years old, married (wife and two children), and has a high school education supplemented with two years of night school. He has been with Southern for 20 years, starting as a secretary and later moving to production control and working foreman at Wheatville. He was a sergeant in the Air Force during World War II. His present position is the production planning supervisor of the Midwest Division plant, having been one of the original supervisory staff who moved to Terryville from Wheatville. The following conversation took place between the professor and Don:

PROFESSOR: Would you please tell me what your job involves?

DON: As production control supervisor, I plan the work for all of he presses in the pressroom. We keep the records of the schedules on those presses, the amount of work that is ahead of each one of them, our future load, and we try to keep them adequately covered as of the immediate time.

PROFESSOR: You are concerned primarily with planning the amount of work and the timing of that work on the different presses?

DON: That's right. The pressroom doesn't see the order until we take it out to them and tell them to run it, and it's our responsibility to receive that work, back load it ahead of the presses, and then line it up to the best advantage to make the shipping dates we have promised to the customer.

PROFESSOR: Is your general objective the shipping date? Is that what you're shooting for?

DON: Yes.

PROFESSOR: Now, what about this stock form function?

DON: Well, we have our stock form control in a different location from the other plants. As a matter of fact, we have 3 plants in the Eastern Division, and each one is handling it separately. In Wheatville the stock forms were kept—ledgers were kept—the orders were initiated by the materials control section where the presses were actually lined up; so they did not keep a close working knowledge of the press schedules as they existed with the result that they just entered orders when they felt like it. They had established low limits with no regard to press time. They would have no working knowledge of the outside schedule; therefore, they might come in right at the same time we have a bunch of other orders and say that we need immediately a large amount of a stock item. We were continually running into situations like that which meant that something suffered; either we didn't get the individual customer's orders out or we were out of stock for a time.

PROFESSOR: And the reason for that is they were not familiar with the press planning situation when they issued their stock form order to produce more?

DON: The second thing that we discovered was that in Wheatville it was the same as it is here. We now carry a number of different stock forms. We suggested when they had an order for singles, for instance, or one fly that they check the 2, 3, 4, 5, 6 to see whether they are close to ordering on them; and if we had the 103's on the press, we could go ahead and run all of them—if we had the plates on the press. We could run them much faster and save press time if we ran two or three of them, but usually we would continually get in the situation where today we would get an order for 103 singles; 2 days from now we would get an order for 103 double; and in 3 days we would get an order for 103 four-part. We would put those on the press 3 different times—put the plates on the press 3 different times and change over for that size.

PROFESSOR: As a result you would lose time and money?

DON: We would lose press efficiency. Now, that is the background and the reason why we put stock forms into production control.

PROFESSOR: Under the production superintendent as one of his major responsibilities?

Don: Well, that is one of the problems that is facing us right now. Although we moved the physical location to the production control section, which operates under the plant superintendent, we left the responsibility with the purchasing—Teller, because he would have had it if it had been set up the same as Wheatville.

Professor: Teller has the responsibility; Katz, the authority, which he delegated to you.

Don: That's right, and the reason we put it there is because we can draw on these stock forms as a fill-in. That was our idea. If we had a short week in the schedule, we would run through our stock forms ledger immediately and possibly build up the schedule—gives us something to run. If we saw a big load coming, we would try to prepare for it. We would try to prepare and build our stock forms up while we had the time.

Professor: What you are saying, in essence, is that you wanted the stock form function because it would be more convenient for production planning?

Don: And we felt that we could also keep the inventory high enough to be better able to meet our customers' needs.

Professor: What about Teller?

Don: The same thing as Wheatville. He does not know how many custom orders we are running. So we run into a conflict between stock forms and custom orders.

Professor: Do you think that you can do a better job of controlling stock form inventory than Teller?

Don: As far as the inventory on hand and so forth, I don't know if I can do any better job than he can. Without expecting him to have the complete background of the press schedules at all times, it would be necessary for him to allow himself more time to get them into stock and, therefore, a higher low limit than what we would have to at our standpoint because we can run down below that and still see a spot where we can get it in where he can't see that, not seeing the schedule every day.

Professor: Can you tell me how a stock form order comes in to you?

Don: When it is received in the mailing room, it is given to the order department where they price it and check it as it being a stock item at the Midwest, and they pass the production copy on down to us where we take the items off the ledger. We take it on out to the shipping department where the forms are shipped.

Professor: Could this function be done by the order department?

Don: As far as maintaining the ledgers and the orders, they could; but again they would run into the same problem—they would not have the working knowledge of the press schedule and, therefore, they again would have to allow themselves more time in all probability to replenish stock than we do at our plant.

Professor: What is the primary factor concerning stock forms when an order comes in?

Don: Speed. However, we need speed and an inventory on hand to fill the order.

Professor: In the Gott plant, don't they handle this function in the office?

Don: Apparently they do. I have not been in the Eastern Division since they set it up, so I cannot pass too much information on their method. I understand that theirs is being handled under the office manager up there.

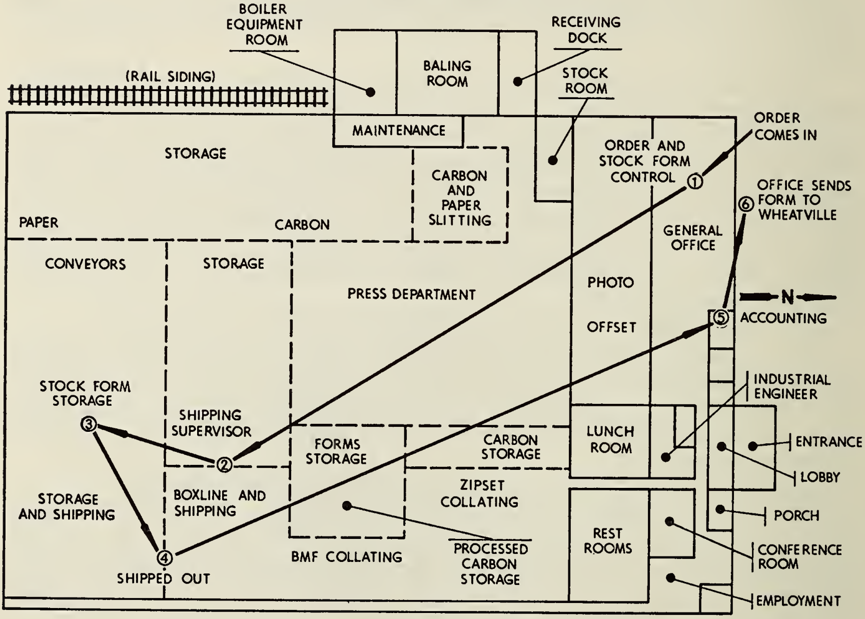
Professor: And evidently it works very well?

Don: Again I don't know. My only thought on that is I feel it should be in the location where it will be handled with the least amount of trouble and with the least amount of money tied up in inventory and with the least amount of communications where orders can be rushed through, and orders can be worked in.

There is one thing in the way we are handling it now that has created some problems. I have been maintaining the ledgers, inventory, and so forth, but Teller has retained the responsibility for it; therefore, he gets correspondence relating to additions of stock forms, taking them away, etc. Teller gets part of it, but then apparently, someone in the other division, some of the correspondence is directed to Ted direct. Teller and I neither one see it. In some cases, correspondence on a stock form is directed to Overton with maybe copies to Ted, and I may not get copies of any of the correspondence on stock forms. So, from my own personal standpoint, unless it is decided that along with the actual function we delegate the responsibility and, therefore, the information, the situation is not too good.

EXHIBIT 4

Stock Form Order Flow via Production Control
Midwest Division
(Scale: 1 inch = 40 feet)



Professor: Do you feel that you should be informed on matters regarding stock forms?

Don: That's right. The only thing I'm saying is that whoever handles the maintaining of the ledgers and the control of the stock form should receive copies of all correspondence that affects stock forms, and it shouldn't be spread in here with part of it to one person and part of it to another.

Professor: What you're saying is that the control of stock forms should be accompanied by a flow of information concerning that responsibility?

Don: Yes.

Professor: What do you think of this divided responsibility and authority? Does it work?

Don: Not to any good end. It is divided now and because of it, Teller and I are confused. Overton is getting the orders to us. He can forget about them.

But because Teller has certain reports that he should send into Wheatville, and because he feels that these reports should go in with his name because nobody ever told him in Wheatville that he shouldn't do it, and Ted apparently feels the same way, those reports continue to go into Wheatville with his name, but he has to take them from us.

The real big problem arises when we don't have the stock on hand to ship a stock form order.

Professor: That's an inventory control problem.

Don: That's right, and that's the basis where I felt that the closer you could be to the man who schedules that press and knows the load ahead of that press, the closer you have the stock form to him, the less communication time. I feel we are in that basic inventory problem of keeping the inventory at the lowest dollar figure possible and still being able to maintain shipments at the desired date. I feel that I can keep that closer than can purchasing.

Professor: Have you ever run out of forms?

Don: Occasionally.

Professor: Basically, then, you are concerned with production planning and preparatory work?

Don: That's right, and the reason goes back long before the Midwest Division was ever dreamed of when they determined at Wheatville that it was the better idea. And it hasn't been that long ago—20 years ago or a little more—that the production control department was organized as such in Wheatville and took over these planning functions. Up until that time an order was laid on a stock out there in the pressroom and a pressman went back and picked up an order and was all set. But as you grow, those things don't work too well. You lose track of an order, you get a tough one and everybody just passes it up and somewhere in the line someone has to run it, which, of course, is the reason why you have this.

Professor: How long have you been working for Southern Corporation?

Don: 20 years in production control work.

Professor: Did you have anything to do with recommending the stock form function be in production control here?

Don: Yes, it was my recommendation. We (Katz, Teller, and I) got together and decided to try it this way. The reason was that in my function in Wheatville I was assigning work to all the presses, and in doing that I received all the stock form orders from the materials control section; and in the case of the stock form press, I was actually scheduling the stock form press. If they wanted stock forms in a hurry, they came to me. I was the guy who had to go back up to materials control and try to get some stock form work to keep the presses running. So, because I had been dealing with that thing for a little over 10 years in my work in production control department, I formed these opinions.

Professor: So when you came down here, you recommended that stock forms be put under production control?

Don: Right. Katz has gone along with me. After I explained the situation to him, he felt that there was enough merit in it that we got together and established it where it is now.

Professor: How about Teller?

Don: We all sat down together and discussed the pros and cons, and I apparently presented a good enough case that they thought it was worth a try. So after a discussion with Ted, Ted elected to give it a try in the production control department on the basis of my recommendation.

Professor: What do you think about this policy of decentralization? That is, do you think that Ted should be allowed to do something different from the other plants?

Don: Yes, except, I think that whenever anything is handled in a different manner in one division from another, that the other division should be kept informed as to how well it is functioning so that if they find, for instance, that we are doing something down here that is working out better than the way they are doing it in Wheatville or doing it in Gott, then the other divisions can profit by our experience. And, likewise, the other divisions would give us information. Of course, most of us know how they have done things in Wheatville, how they change there, but they again should pass that information down to us. And if we feel that ours is still better after we try or go over theirs, well, then we stay where we are. But I feel in a corporation as we are now, we've grown too fast all of a sudden—but communications is one of the biggest headaches in any business and the bigger you get, the more headache it becomes.

Professor: Do you have any ideas as to how to whip this communication problem as your organization grows?

Don: I feel you have a right to get information concerning your responsibility. Communication has got to accompany both authority and responsibility. But if you have the responsibility without the authority to get that information to you, then you have to depend upon another person to keep you informed. For instance, right now there are certain items which very possibly Katz will hear about. Well, I have to depend on Katz to get that information down here to me. It rightly should come to him, but if I am to do my job properly, he also has to let me know about it. That's why in many cases an extra carbon copy of a letter will save a lot of time.

Rod Teller, the supervisor of purchasing and materials, discussed the problem with the professor. Rod is 32 years old, married (wife and three children) with a high school education. He had been in the Air Force for four years. His 13 years' experience with the company consisted of working in the home office purchasing department in nonsupervisory clerical positions before his present position.

Professor: What is your responsibility in this plant?

Rod: Basically, purchasing of all our raw materials—paper, ink, so forth—plus storage, receiving, and inventory control.

Professor: Would you tell me your point of view about this stock form problem?

Rod: Well, you probably already know from your previous interviews how the records of this particular function are controlled right now, and how it originated. When we first came down, it was in the job description, so to speak, that our function of purchasing and materials control would have that function. Basically it is an inventory control function—maintenance of the stock and so forth.

Professor: How is it handled in the Gott plant?

Rod: Originally, as I understand it, when Gott started out, it was handled the same way there under the purchasing department, and for some reason, I don't know why, in the past few years the responsibility has been removed from purchasing and, I believe, placed in the control of the equivalent of our office manager here.

Professor: And how is it handled here?

Rod: I have the responsibility for the control even though the physical records are maintained by the production control department. I am still responsible for the performance, let's say, the upkeep of the records, the maintenance of stock, and so forth.

Professor: Do you think you ought to have this function?

Rod: Well, of course, you can get into a lot of discussions one way or another on it. I could say yes to that since I feel that it is basically an inventory control function and that all inventory should be under one control head. I would be in favor of putting it wherever we could accomplish the job best. This could be determined. In other words, we've had the present structure for approximately 2 years now. If production control can prove that that's the best place physically for the records to be maintained, then that's the most optimum department to have the records kept. If another area proves to be better than any other, I would say put it there. But I would say that whoever has it, wherever it is located, that the man responsible for it, whoever it would be, would have full control from one end to the other end; not just a phase of it.

Professor: How much of a problem is this stock form situation?

Rod: I would say that here, getting specific in our particular case, it has caused some concern especially in the area of what we're going to carry and so forth. I mean we have divided opinions as to what we should carry in our stock form line. By and large the decision is made by our marketing and sales division as to what they feel each of the division plants should carry in order to serve that particular geographical area.

Professor: Now when you switch over from the present system to a direct placement of orders who will make these decisions concerning the stocking of a finished good inventory item?

Rod: I don't think that this is relevant to our present problem.

Professor: Okay. Hmm. Well, can you describe the flow of work for a stock form order?

Rod: The order is first received, made into a carbon, then it goes to the order department where our internal order form is written up. The form is priced, the quantity to be shipped is entered on our form, and then it is forwarded to the production control department. Now the items are deducted from the ledgers, correct entries made, and at the same time it is checked to see whether or not sufficient stock is available to make the shipment. And if it is, then the entries are made on the ledgers. Then the order is forwarded to the shipping department, and the shipping department pulls the material from the stock and ships it out. Then the order comes back up to the order department again for closing.

Professor: How long does it take once an order reaches the mailing desk until the order is shipped?

Rod: Well, we're supposed to have it shipped from the plant within 24 hours after receiving this order. With that kind of a deadline, so to speak, we're not in the position to leave the forms lying around somewhere for somebody to handle whenever they get time.

Professor: What would happen if you changed the flow to inventory control?

Rod: Actually, there wouldn't be too much difference in the flow than there is now. It would just be a matter of the forms, after they leave the order department, coming to inventory control rather than going to production control as they do now.

Professor: How about the Gott plant system of going only through the order department?

Rod: If you had one man who was responsible for receiving the order, writing up the internal order forms, deducting or making necessary entries to the ledgers, pricing, and everything at one time, and then delivering them to the shipping department, you've eliminated a couple of steps in the process. That would step up the speed—would step up the flow of the forms.

Professor: How about the control?

Rod: There again, I think you would still get some problems in that the order department as such is in somewhat the same area as the production department. They are slanted towards getting the order through just as fast as they possibly can. That's not to say that if a particular individual had the control, they would sacrifice, but I feel that if there is going to be a biased opinion or thinking one way or the other, it would probably be slanted toward getting the order through or getting it out; and if we've got to stock so many of these forms, let's keep sufficient of them on hand so that we can meet every requirement.

Professor: What's the disadvantage of a lack of control?

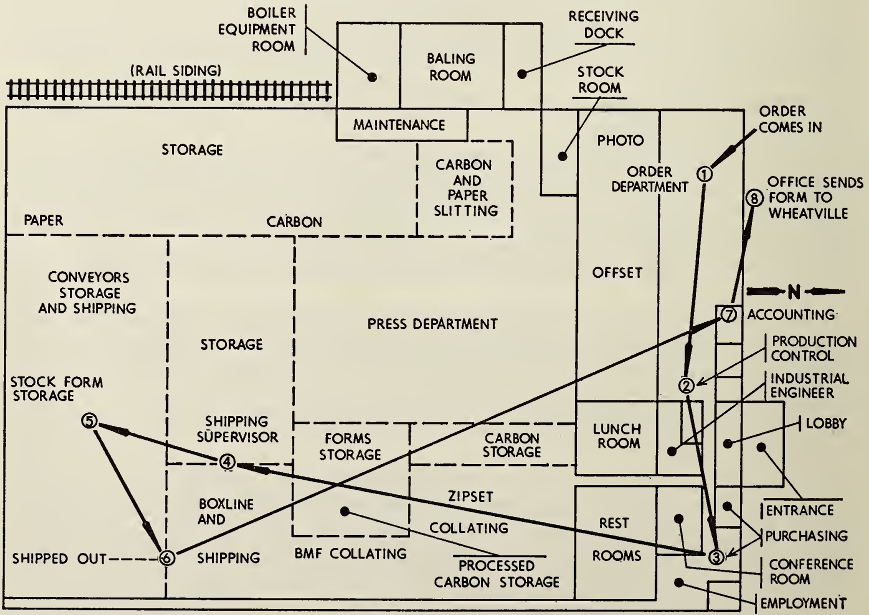
Rod: We have more dollars tied up than you would necessarily need to have. In addition, the longer we keep these forms on the floor, let's say, the more opportunity there might be for customers' complaints because of their poor legibility, because of carbon age, and one thing or another. You would certainly be tying up more floor space. Of course, if we are higher up on money, we're going to pay higher taxes.

Professor: Do you have any other thoughts about the stock forms?

Rod: Shipping, of course, becomes involved with the actual storage of the forms when the forms are produced here, and we produce most of these forms right here. When they come through the line, it is their responsibility to see that they're taken off the conveyor lines and properly stored. And, of course, at the time they have the responsibility to see that the right materials are pulled from stock and shipped. And then, of course, I enter into it from the overall control phase. Reports and so forth that go to Wheatville each month, while they are prepared by production control, come to me. I review them, and what have you, and then forward them on to our Wheatville director of purchases.

EXHIBIT 5

Stock Form Order Flow via Purchasing
Midwest Division
(Scale: 1 inch = 40 feet)



I feel that as this thing is set up now, it is somewhat of a stepchild function. It was set up, and then it was decided that the physical storage and shipment of these things would be controlled under the shipping function. I can't help but feel that, from instances that have occurred, that this thing is somewhat of a stepchild. Well, it's—let's say a term would be a secondary function that they've got. It's something that they do, but it's not uppermost in their minds to see that the stock is properly stored and what have you.

Professor: Shipping is a responsibility of yours?

Rod: No, it is not. Of course, you could still get into the same problem regardless of how you change this doggone thing around from what it is now. That is, we've thought about the possibility of putting the function in the office or the order department. You would still be confronted with that problem of who's going to pull them out of stock; who's going to see that they're properly stored; and so on. We thought about the favorable aspects of the records or the job being maintained back there, and I think that's one of the unfavorable things you would run into. There would still be a certain amount of split responsibility in the thing. Maybe it's just a matter of whoever has it just taking the reins in their hands strongly enough to see that the job is done properly. You get into some problems, let's say, I do at any rate. Production control, for example. Shipping, of course, likewise comes under the direct supervision of the plant superintendent, so we're crossing lines, so to speak. And whether it's right or it's wrong, I think there's still some qualms on crossing those lines. When I wouldn't go to Don in the same manner when we've got a problem as I would to someone working directly under me, I would say that's a bad situation.

Professor: You think that when inventory problems come up, you would feel better if these people were under your supervision?

Rod: In other words, I feel that I could straighten them out better, so to speak. Well, let's say, I would have a stronger direct contact. I don't feel too forceful when I'm dealing with a problem that has to be solved because I'm dealing with somebody else's employees. If they were my own, I could speak more frankly or firmly. I feel rather sensitive when it comes to talking with somebody who's not under my supervision.

Another thing. When this plant first opened up, there wasn't any decision as to who was going to have that function. I understood, when we first came down here, as we mentioned earlier, that it was in my job description. But the closer we came to actually having these forms shipped into us and what have you, why we got the heads together, and decided for several various reasons that we would give it a try at placing these records in the production control area on a trial basis. And, of course, we have been going at that trial for nearly two years.

Under inventory control, that is, under my control, the ledgers would be in our department. The order entry and so forth on the ledgers would enter there, and we would then take over as a part of our receiving and storage function, the function that is now being carried on by shipping up to the point of actually getting the forms through the shipping line ready to go out the back door. We could transfer responsibility from shipping to my receiving and storage department. We would have the responsibility for seeing that the forms are taken off the line and stored on the floor properly. Again, storage and the handling of inventory is their basic responsibility.

Mr. Sam Overton, the office supervisor, then conferred with the professor about the stock form problem. Sam is 40 years old, married (wife and six children), with a high school education (some night school). He has 20 years of experience with the company, all of it office work. A Navy veteran, he also has six years of office supervisory experience at Wheatville before coming to the present plant.

PROFESSOR: Are you familiar with this stock form deal?

SAM: You mean the overall procedure in our handling of stock forms?

PROFESSOR: Right. Now, just a little background. What is your position here at the plant?

SAM: Well, office supervisor is my title. I am actually in charge of the order department. I have 7 employees. I have 2 in the order department—2 order analysts. I have 1 in communications and 1 stenographer and 2 clerk typists and 1 mail clerk—that's 7.

PROFESSOR: Do all orders come through you?

SAM: Yes, all of those come through me. We get copies of the orders that Wheatville types, and there are some that we type ourselves.

PROFESSOR: Now would you describe how one of these stock form orders originates?

SAM: Well, the salesmen make a contract and send it to us in the mail. We in turn get an order, number it, and price it; and in some cases it is necessary for us to extend the quantities as such. In some cases they specify strictly the number of cartons, and in other cases we have to break down the number in a carton and extend it out of that quantity. We separate it; and we type what we call a stencil label for any number of cartons because our stock label is set up in such a way that we are able to type the stencil label and impress the complete address onto the carton for shipment; and we also type the bill of lading at that time.

Then we pass it on to the production control department. There it is recorded. Personnel take from the order the number of cartons in a particular size and record it against the ledger cards. Then they take it and transport it to the shipping department.

PROFESSOR: As I understand it, you have a policy of guaranteeing 24-hour delivery from the plant when the order is received.

SAM: Right. Speed becomes essential.

PROFESSOR: What do you think about the present way of handling the stock forms? Is it the most effective way?

SAM: Personally, I say no because it goes through too many hands. I think the way it is transferred now from the order department to production control creates an extra operation as such. In other words, I feel that we can control the inventory and have the order analyst who prices the order control the stock at the same time. All he would do is make out what we call a house order to replenish his supply. And all he would do is say that he is low and then the actual scheduling of press would have to be done by production control.

PROFESSOR: Could the whole production scheduling be performed by the order analyst?

SAM: I have never actually analyzed that phase of it. There would be too much incorporated into the job, I feel. In other words, his job as such pertains strictly to stock forms.

Speed is required in the whole operation, and to me the order has to be priced so the function would have to start in the order department. There would be no getting around that. We could eliminate or bring the ledgers as such to the order analyst and let him control it from that stage.

I was just up to our Gott plant and they have what they call their stock form ledger clerk. He has a set of books which is the same as our ledgers here, and he controls the natural inventory. When the supply is low, he actually writes the house order and turns it over to production control.

PROFESSOR: What's wrong with it being under production control?

SAM: Well, I feel that the production department doesn't have a chance to control the inventory, I don't think, as readily as we will be able to control it because we also have what we call storage orders, and we are controlling those. In other words, we take our own inventory and everything on those, and I feel that we can take care of that at the same time.

PROFESSOR: What are these storage orders?

SAM: Storage orders are orders that we run and we will ship later to customers. In other words, every 3 months they want a certain amount, a certain number, of cartons. Well, we control that and make those releases against the storage orders. We produce a whole batch of them and release them every 3 months as they are desired.

PROFESSOR: In other words, you control finished good inventory?[1]

SAM: Right.

PROFESSOR: Do you get many calls on the telephone concerning stock forms?

SAM: We get a lot of requests from the salesmen and they will say, "Do you happen to have about 20 cartons of such and such stock form in stock right now?" Well, we have to go to production control and ask them, "Do you have that many in stock or not?" I feel that if we have the file, we could probably or definitely be able to give them better service by saying we'll check right now.

PROFESSOR: How about Teller? What does he think?

SAM: I actually haven't had much discussion with him other than I take my complaints to him about stock being low or something like that because he technically is responsible for the stock forms. There are times when we run out of stock on certain sizes, and it has to be run on the press again. Well, we check our records to be sure that the stock forms are turning over as they should. We find that some of them are behind, and I always go to purchasing.

PROFESSOR: You say you go to Teller because he is responsible for inventory control of stock forms?

SAM: Well, technically he is because of the fact that when we are out of those sizes, he in turn gets the final report each time. He makes the final report although the function as such has been placed under production control.

PROFESSOR: Is this good management?

SAM: Well, it is in the functional part of it, yes, but probably not the overall. Purchasing is responsible for this inventory.

PROFESSOR: What would happen if stock form control were transferred to you?

SAM: I would say that we would probably provide the service that we have to give on this, and we have had some problems. Of course, we have straightened them out by experience, but I think we could maintain an inventory easier that way.

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[1] The vice-president of the Southern Corporation stated the following in a letter to the professor: "Inventory control as a function of the business is usually fairly well defined and divided into the categories of raw materials inventory and finished goods inventory. Inasmuch as the nature of our business is such that most of the product that we produce is tailor-made to the customer's specifications and is shipped immediately upon completion of the manufacturing processes, we differ from most industrial organizations in that we have no finished goods inventory. Basically our problems are raw material inventory and work in process.

"Stock forms are the only printed items that we manufacture which necessitates our having any finished goods inventory.

"In dollar volume and production, stock forms are a relatively small percentage of our total production."

Professor: Can you give me an example?

Sam: We had one that I can recall. We were able to supply them with half the order, then we back ordered the balance, and it took us approximately 30 days to get the other half ready for them.

Professor: On a stock form order?

Sam: Right.

Professor: Did they complain about it?

Sam: Yes, they did. That's the reason I got into it. They complained to me because I'm the contact man between sales and production.

Professor: All right. What you're saying is that you think it would be more advisable to have this stock form function under your direction because it comes to you first, and you can give faster service to the field, and you can eliminate a step between you and shipping.[2]

Sam: I feel that when the stock form clerk gets the order, prices it, and takes it off the ledgers and passes it to the girl who types the stencil label and the bill of lading, it is ready for distribution or can go directly to the shipping department. Another thing is that when you take it to production control, it lays a certain amount of time because, like anything else, if you are not waiting for it you leave it laying until you get to it. This way we eliminate that delay time in there, too, because we are handling it right on time.

It's true that for better efficiency of the press, production could actually do that; but regardless of where that inventory would be kept, they could still do the same thing. In other words, they would still have access to the files even though I am controlling it. They would work with the stock form clerk as such. In other words, if they're ready to run stock forms on the press and they happen to have available another couple of hours or so of press time, they could automatically talk to the stock form clerk, and they could set it up in that respect.

Professor: I understand that you have been with the company for 20 years. What did you do before you came to Terryville?

Sam: I was the order department supervisor in Wheatville.

Professor: Then this problem is right down your alley?

Sam: That's right.

Professor: Do you think you can handle it better in the office than they do at present in materials control at Wheatville?

Sam: Yes.

Professor: Why do you want the function?

Sam: After reviewing the entire situation in our Gott plant, I asked them what they did before. They took that function away from purchasing. I do feel that when a salesman is on long distance, and I have to go up to the other end of the office to find out, it isn't good. Most of them wouldn't call unless they are in a bind. There are times that we can recommend to them, too, that we are out of 143 two-parts, but I've got enough in three-parts. To me that's getting where we should be in an order department, even on an advisory basis or service as such. If you can't take care of them in that particular line, at least you can come back and say, I can do this for you, instead of leaving them high and dry and saying, I can't do it.

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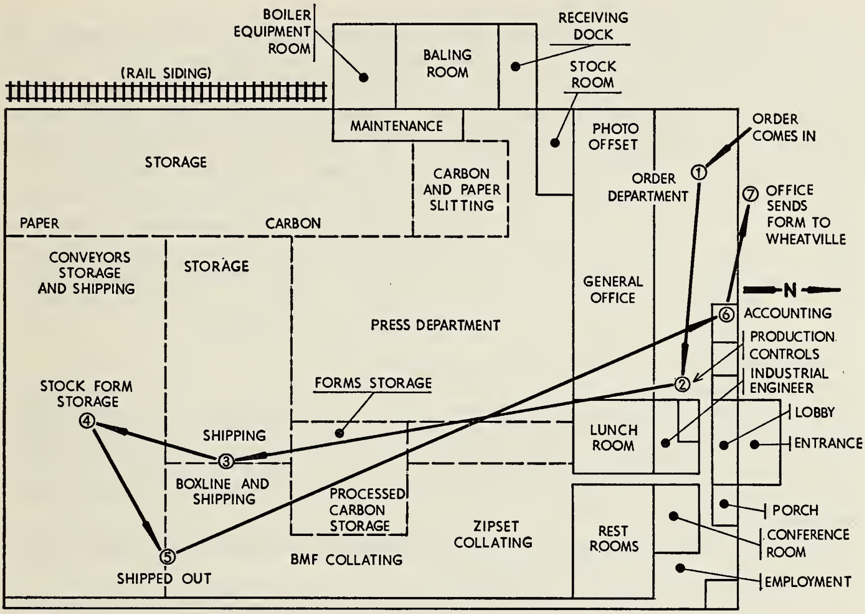
[2] The vice-president, Mr. Appelman, also wrote: "All stock forms stored and shipped from any given plant are not necessarily produced in the plant in which they are stored and from which they are shipped. By the same token, all stock forms that are produced by a given plant are not necessarily stored in that plant, nor shipped from that plant to the customer."

EXHIBIT 6

Stock Form Order Flow via Office
Midwest Division
(Scale: 1 inch = 40 feet)



Jed Katz, the production superintendent, discussed the problem with the professor: Jed, a graduate industrial engineer from a big ten university, is 38 years old. He has 10 years of experience (seven in a supervisory position) with the company. He has worked with two other companies. He also served in the Air Force. He is married, with four children.

Professor: Jed, would you please describe your position?

Jed: My position is plant superintendent. I am in charge of the manufacturing operations in this plant. I supervise production control, photo offset, press and carbon, collating, boxing and shipping, maintenance, and industrial engineering. In press and carbon we have 3 foremen under the supervisor, and in collating we have 2 foremen under the supervisor. There are about 120 workers.

Professor: How about this stock form problem?

Jed: This goes back quite some time. Before we came down here, as I recall, after Don Harvey was hired by me as the supervisor of production control, we were discussing his function one day. He had worked closely with the schedule in running stock form orders on the press. And he felt it would be advantageous to have this control under his jurisdiction for better planning and better production.

Professor: Did his idea make sense to you?

Jed: Yes. For more efficient planning and production. On our stock form press we have peaks of production, and then some low spots where we feel it's advantageous to stick our stock form production in that place. Also, he can look ahead; he can tell pretty well, you might say, heavy weeks of production. Now, if he sees two or three heavy weeks coming up, he may choose to produce the stock forms this week, in a light week, because he knows he can't get them out in the ensuing week. We're money ahead because we can produce more efficiently and get more forms per hour.

PROFESSOR: Is this stock form problem of much concern to you?

JED: Well, there's a problem. I'm not directly concerned. It's more in Harvey's area, and, of course, being his superior, I am involved to try to help him get it straightened out. There is something of a communications problem. We have communications between Wheatville and Teller down here, communications to Overton sometimes, and also to Sawyer. Harvey has the function right now, but communications are going around him and very few to him. It's been a nuisance, but from what I gather, it's nothing bad. No one's up in the air or beating the table. I think under the circumstances, it has run fairly smoothly, except sometimes some people weren't clearly informed as to what should be done or what shouldn't be done. That's getting back to communications. Well, I look at it two ways. One, of course, is customers' deliveries. I am interested in deliveries; that's one of my prime interests.

PROFESSOR: How would you solve the problem?

JED: I think first we should resolve where does this function belong and decide once and for all that that's in the office, in my division, or in purchasing. Once the decision is made, and Ted makes the decision after consulting with us, I think we should try to sell, if we have to, the corporate people involved on the reason for that change, and then give that responsibility to that person and also the authority.

PROFESSOR: Do you believe in decentralization of authority? Should Ted make the basic decisions here at the plant?

JED: I think to a point, yes, unless, of course, our executive vice-president sees an outright error. He can't just stand by and see something going wrong. He has to step in, of course. He reserves that right all the time. I think any man, to be effective, needs somewhat of a free hand to do his best job.

PROFESSOR: What you're saying is that too much supervision is not too effective? Each man should have a say in what he does?

JED: Right. Now, of course, we need corporate authorization on some purchases and some things we buy, but by and large I think Ted has a pretty free hand.

PROFESSOR: What do you think are the deciding factors in this situation?

JED: Customer service, I would put first—that is, within reason. Efficiency and press planning are more or less secondary. And then inventory control, tertiary.

*Central Supply Company**

"I suppose the Green report did quite a bit of good, but I am wondering if it was worth the money. Mr. Smith, the majority stockholder, had very good results with an analysis of another company he controls and he thought that a consulting firm could improve our operations. The analysis disrupted our organization for five weeks and I believe it is the feeling of several of our people that the consulting firm did little good." Thus spoke Mr. Sam Martin in July, 1960. Mr. Martin is vice-president and general manager of Central Supply Company. He referred to an analysis of the Central Supply Company that the Green Company, management consultants, had undertaken in June, 1958.

Central Supply Company was incorporated in 1929 to manufacture and distribute a wide variety of sanitary supplies. The business began rather accidentally when Mr. B. C. Smith, food broker, and Mr. James Briggs, purchasing agent for a large candy manufacturer, agreed to purchase certain real estate. The real estate was sold for a profit and the two men wondered how it could be invested. They decided to organize the Central Supply Company with an original paid-in capital of $2,500 comprised of 25 shares of common stock owned equally by Briggs and Smith.

History of the Company

Despite the fact that the company was organized on the eve of the Great Depression it prospered, and by retention of a portion of the earnings, the company's net worth grew from the original $2,500 paid-in capital to a net worth of almost $86,000 and total assets of over $193,000 as of December 1, 1959. Sales volume increased from modest levels to approximately one-half million dollars annually (See Exhibits 1 and 2 for comparative balance sheets and income statements).

In 1938 the stockholders agreed that no stock would be sold by any stockholder without first offering the stock to the company. At this time the stock was owned by James Briggs, president; Frank Foote, vice-president; William Basket, secretary; and B. C. Smith, treasurer; all of whom comprised the board of directors.

The company continued to grow and in 1941 the need for additional working capital was felt. The board of directors authorized the officers to borrow funds from stockholders by issuing long-term subordinate debenture notes. Authorized capital was increased from $10,000 to $30,000 in 1942 and at the end of that year 84 shares of stock were given to stockholders in exchange for $8,400 of 5 percent debenture notes.

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* Prepared by Arthur G. Vieth, University of Chattanooga.

EXHIBIT 1

Central Supply Company 1945–59
Comparative Balance Sheets

Assets	*1959*	*1958*	*1957*	*1956*	*1955*	*1954*	*1953*	*1952*	*1951*	*1950*	*1949*	*1948*	*1947*	*1946*	*1945*
Current assets															
Cash on hand and in bank	24,043	11,852	30,363	33,684	3,889	3,918	1,644	7,353	6,369	5,078	9,228	10,176	5,533	13,041	10,385
Accounts receivable—Customers	40,337	49,895	38,397	38,124	53,874	34,104	35,376	35,624	28,695	33,790	25,515	24,309	24,532	16,988	11,361
Accounts receivable—Employees	601	178	890	377	34	1,458	383	195	93	78	45	493	194	...	...
Notes receivable	1,090	2,990	...	124	...	...	...	1,228	...	...	...	...	...	...	...
U.S. bonds	...	...	...	...	...	...	...	...	...	...	...	...	...	...	2,000
Inventories	59,214	70,127	60,310	55,824	59,860	74,555	78,387	62,144	67,380	57,855	44,338	48,090	34,815	30,569	24,465
Total Current Assets*	125,286	135,043	129,959	128,626	117,164	114,035	115,789	106,544	102,537	96,799	79,125	83,068	65,074	60,598	48,212
Fixed assets—Net	5,186	7,277	3,244	4,692	6,530	6,875	6,517	4,446	5,155	5,353	1,703	2,056	1,850	2,172	498
Other assets															
Employee Group Insurance	91	...	...	...	...	...	...	...	70	207	69	63	55	33	32
Prepaid expense	70	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Notes due from Sale of Stock	...	...	2,500	4,500	14,021	14,021	14,021	...	...	...	...	...	...	...	...
Cash surrender value—Life insurance	3,204	2,414	1,944	1,027	...	...	...	...	...	...	...	...	...	...	...
Treasury stock	59,280	59,280	59,280	59,280	...	...	...	...	...	...	...	...	...	...	...
Investments	1,020	1,000	1,000	...	...	...	...	...	...	...	...	...	...	...	...
Total assets*	194,137	205,013	197,928	198,126	137,716	134,931	136,327	110,989	107,762	102,359	80,898	85,187	66,979	62,803	48,742

LIABILITIES	*1959*	*1958*	*1957*	*1956*	*1955*	*1954*	*1953*	*1952*
Current liabilities								
Accounts payable	14,253	11,629	8,193	7,493	8,145	8,936	15,652	16,054
Social security taxes	1,138	804	438	512	565	510	354	306
Withholding tax	1,280	1,314	1,079	1,092	1,259	1,595	810	798
State sales tax	523	567	455	577	602	561	467	460
Franchise and excise tax	504	225	1,022	1,054	703	610	567	427
Notes payable	...	22,990	...	4,400	...	2,550	...	...
Reserve for federal income tax	2,154	...	5,440	7,159	4,332	3,530	3,291	2,458
Total Current Liabilities*	19,852	37,529	16,627	22,287	15,606	18,292	21,140	20,503
Long-term liabilities								
5 Percent debenture notes	30,800	30,800	30,800	39,600	...	...	...	...
Net Worth								
Capital stock	57,900	57,900	57,900	57,900	57,900	58,600	60,100	50,000
Capital surplus	6,861	6,861	6,861	6,861	6,861	6,861	8,061	...
Earned surplus	79,723	71,924	85,739	71,477	57,348	51,177	47,025	40,486
Total Net Worth*	143,485	136,685	150,500	136,238	122,109	116,638	115,186	90,486
Total Liabilities*	194,137	205,013	197,928	198,126	137,716	134,931	136,327	110,989

* Figures may not add to total because of rounding.

EXHIBIT 2

CENTRAL SUPPLY COMPANY 1945–59
Comparative Income Statements

	1959	*1958*	*1957*	*1956*	*1955*	*1954*	*1953*	*1952*	*1951*	*1950*	*1949*	*1948*	*1947*	*1946*	*1945*
Sales	492,558	500,671	468,356	464,472	517,559	452,434	435,202	433,169	510,870	462,350	361,520	373,356	328,199	297,672	250,445
Cost of sales	354,859	370,375	331,117	326,218	366,004	334,548	328,482	334,396	395,678	349,322	268,736	271,953	237,914	216,628	186,966
Gross profit*	137,699	130,296	137,239	138,253	151,555	117,886	106,720	98,772	115,192	113,028	92,783	101,403	90,286	81,044	63,479
Selling expenses	72,909	75,768	70,431	70,605	82,515	61,232	55,648	49,424	53,462	52,437	45,049	44,794	38,690	33,890	†
Selling profit*	64,790	54,328	66,807	67,649	69,040	56,654	51,071	49,348	61,731	60,591	47,734	56,609	51,596	47,154	
Administrative expense	55,583	61,249	44,422	45,444	52,659	43,390	40,965	41,432	40,238	36,729	33,989	35,354	32,390	29,063	51,527†
Operating profit or (loss)*	9,207	(6,721)	22,385	22,205	16,382	13,264	10,106	7,916	21,493	26,861	13,744	21,255	19,206	18,091	11,952
Other income	6,262	4,521	8,211	6,687	4,491	4,459	4,888	†	5,754	4,309	3,516	3,831	3,442	3,096	2
Other expenses	8,201	9,414	9,063	5,027	6,433	5,955	4,027	†	5,826	4,716	3,269	3,408	3,311	3,361	...
Profit or (loss) before federal income tax*	7,268	(11,614)	21,534	23,864	14,440	11,768	10,968	8,068	21,421	23,856	13,991	21,678	19,336	17,826	11,954
Reserve for federal income tax	2,154		5,440	7,159	4,332	3,530	3,290	2,458	6,168	5,487	3,118	4,919	4,347	4,043	‡
Net profit or (loss)*	5,114	(11,614)	16,094	16,705	10,108	8,238	7,678	5,610	15,253	18,369	10,873	16,759	14,989	13,783	‡

* Figures may not add to total because of rounding.
† Selling and administrative expenses not segregated.
‡ Unavailable.

By 1943 the effects of World War II were beginning to be felt and economy measures were instituted. Salaries were reduced and additional funds obtained from the stockholders by the exchange of 16 shares of stock for $1,600 of 5 percent debenture notes. Price ceiling restrictions squeezed profits, and made necessary the economizing of funds. In the following year, however, business improved and salaries were increased slightly. A dividend of 12 percent was paid in 1944.

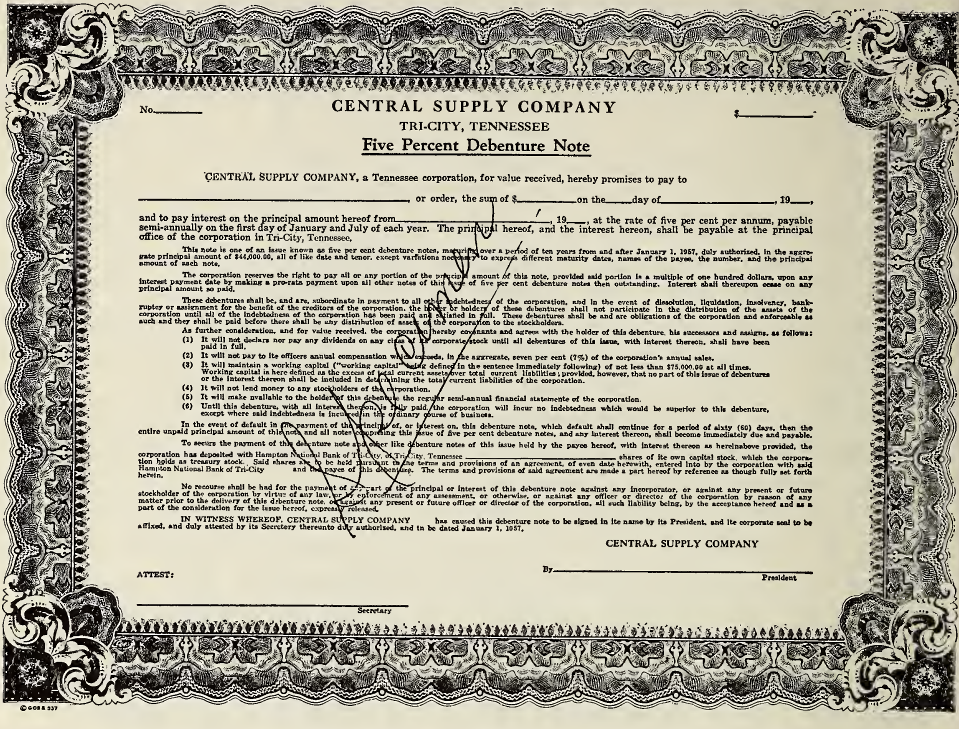
After the war the business expanded rapidly with annual sales rising from $250,000 in 1945 to $373,000 in 1948. In 1946 a 50 percent stock dividend increased outstanding stock to the authorized $30,000 amount. In 1948 authorized stock was increased to the present $100,000 (1,000 shares) level. Mr. Foote became ill in the latter part of 1946 and withdrew from active management. Mr. Basket assumed more responsibility, and in 1949, upon the death of Mr. Foote, he was named vice-president.

At the annual meeting in January, 1950, a stock dividend of one share was declared and during the year liberal cash dividends were paid. During the early 1950's several important management changes were made. Mrs. D. B. White resigned after 14 years of service, and the following year, 1951, Mr. Bailey, a salesman with 16 years of service, retired. Mr. Basket, vice-president and general manager, passed away in 1952 and was replaced by Sam Martin, a salesman with the company since 1939. In 1953 Mr. Briggs, one of the original founders and president of the company, passed away. The new officers in 1953 were B. C. Smith, president; Sam Martin, vice-president and general manager; Charles Scholar, secretary; and B. C. Smith, Jr., treasurer. Mrs. Basket and Mrs. Briggs assumed active participation in the company by attending stockholders' meetings, and during a meeting in the latter part of 1953 they were informed by B. C. Smith of their importance to Central Supply Company. Also, in 1953, the company entered into a stock sales agreement with Mr. Martin and Mr. Scholar whereby each man was permitted to purchase 50 shares of stock. The company also purchased life insurance policies on the lives of Mr. Martin and Mr. Scholar of $7,500. The face values of these policies were subsequently increased to $20,000. A similar policy was carried on the life of B. C. Smith.

In 1954 the board of directors considered the advisability of purchasing the stock of Mrs. Briggs and Mrs. Basket. In 1956 an agreement was entered into with Mrs. Briggs and Mrs. Basket to purchase 312 shares of stock owned by them and to hold it as treasury stock. It was felt such a purchase was desirable since the stock might fall into the hands of outside interests. The purchase price was $190 per share with the company paying 25 percent cash and 75 percent in 5 percent subordinated 10-year debenture notes (See Exhibit 3).

In 1954 the company purchased National Products Company of Calhoun, Georgia, to be used as a branch, but it was sold on very favorable terms at the end of the following year. In 1957, another company, Rust

EXHIBIT 3



No.________ **CENTRAL SUPPLY COMPANY** $________

TRI-CITY, TENNESSEE

Five Percent Debenture Note

CENTRAL SUPPLY COMPANY, a Tennessee corporation, for value received, hereby promises to pay to

________________________, or order, the sum of $________ on the ____ day of ______________, 19____,

and to pay interest on the principal amount hereof from ________________, 19____, at the rate of five per cent per annum, payable semi-annually on the first day of January and July of each year. The principal hereof, and the interest hereon, shall be payable at the principal office of the corporation in Tri-City, Tennessee.

This note is one of an issue known as five per cent debenture notes, maturing over a period of ten years from and after January 1, 1957, duly authorized, in the aggregate principal amount of $44,000.00, all of like date and tenor, except variations necessary to express different maturity dates, names of the payee, the number, and the principal amount of each note.

The corporation reserves the right to pay all or any portion of the principal amount of this note, provided said portion is a multiple of one hundred dollars, upon any interest payment date by making a pro-rata payment upon all other notes of this issue of five per cent debenture notes then outstanding. Interest shall thereupon cease on any principal amount so paid.

These debentures shall be, and are, subordinate in payment to all other indebtedness of the corporation, and in the event of dissolution, liquidation, insolvency, bankruptcy or assignment for the benefit of the creditors of the corporation, the holder or holders of these debentures shall not participate in the distribution of the assets of the corporation until all of the indebtedness of the corporation has been paid and satisfied in full. These debentures shall be and are obligations of the corporation and enforceable as such and they shall be paid before there shall be any distribution of assets of the corporation to the stockholders.

As further consideration, and for value received, the corporation hereby covenants and agrees with the holder of this debenture, his successors and assigns, as follows:

(1) It will not declare nor pay any dividends on any class of its corporate stock until all debentures of this issue, with interest thereon, shall have been paid in full.

(2) It will not pay to its officers annual compensation which exceeds, in the aggregate, seven per cent (7%) of the corporation's annual sales.

(3) It will maintain a working capital ("working capital" being defined in the sentence immediately following) of not less than $75,000.00 at all times. Working capital is here defined as the excess of total current assets over total current liabilities; provided, however, that no part of this issue of debentures or the interest thereon shall be included in determining the total current liabilities of the corporation.

(4) It will not lend money to any stockholders of the corporation.

(5) It will make available to the holder of this debenture the regular semi-annual financial statements of the corporation.

(6) Until this debenture, with all interest thereon, is fully paid, the corporation will incur no indebtedness which would be superior to this debenture, except where said indebtedness is incurred in the ordinary course of business.

In the event of default in the payment of the principal of, or interest on, this debenture note, which default shall continue for a period of sixty (60) days, then the entire unpaid principal amount of this note and all notes comprising this issue of five per cent debenture notes, and any interest thereon, shall become immediately due and payable.

To secure the payment of this debenture note and other like debenture notes of this issue held by the payee hereof, with interest thereon as hereinabove provided, the corporation has deposited with Hampton National Bank of Tri-City, of Tri-City, Tennessee ________________ shares of its own capital stock, which the corporation holds as treasury stock. Said shares are to be held pursuant to the terms and provisions of an agreement, of even date herewith, entered into by the corporation with said Hampton National Bank of Tri-City and the payee of this debenture. The terms and provisions of said agreement are made a part hereof by reference as though fully set forth herein.

No recourse shall be had for the payment of any part of the principal or interest of this debenture note against any incorporator, or against any present or future stockholder of the corporation by virtue of any law, or by enforcement of any assessment, or otherwise, or against any officer or director of the corporation by reason of any matter prior to the delivery of this debenture note, or against any present or future officer or director of the corporation, all such liability being, by the acceptance hereof and as a part of the consideration for the issue hereof, expressly released.

IN WITNESS WHEREOF, CENTRAL SUPPLY COMPANY has caused this debenture note to be signed in its name by its President, and its corporate seal to be affixed, and duly attested by its Secretery thereunto duly authorized, and to be dated January 1, 1957.

CENTRAL SUPPLY COMPANY

By________________________
President

ATTEST:

____
Secretary

©GOES 537

Less Company, was purchased by Central Supply Company. Rust Less is a liquid sprayed or brushed on metal to prevent rust. For a while the product was distributed through a national chain, but was discontinued because of inadequate volume. In 1960 the management of Central Supply Company indicated that Rust Less Company might be for sale. The product was considered an excellent one, but it could not be distributed through the same channels as sanitary and cleaning supplies, and, therefore, required special promotion efforts which the company felt it could not provide.

The Sanitary Supply Industry and Competition

The sanitary supply industry is highly competitive. In the Tri-City territory about a dozen firms service the area. The general nature of the business can be determined from two independent surveys conducted by *Sanitary Maintenance* (See Appendix A) and *Maintenance and Sanitary Supplies* (See Appendix B). Competition in recent years has been intensified by the growth of janitor service firms.

In order to meet the competition of janitor service firms, Central Supply Company organized a new janitor service department. In March, 1960, the company decided to continue the Janitorial Service Department as a separate company, the "Janitorial Service Company, Inc." Rayford Clark was offered 50 percent of the stock of the new company if he assumed general managership not later than July 15, 1960. The parent company agreed to lend $8,000 to the new company in $1,000 notes, the first of which would become due in two years.

Central Supply Company sells a wide variety of liquid cleaners and sealers of all kinds, including floor cleaners, floor oils, and wax. It distributes soaps, disinfectants, brushes, brooms, mops, dusters, dust pans, towels, sponges, steel wool, squeegees, as well as liquid and powdered cleaners for metal, concrete, glass, rubber, and other materials. The company also handles cleaning machines of all kinds such as vacuum cleaners, waxers, and complete floor cleaning machines. Various dispensers for soap, towels, cups, and other products are also sold.

Most of the sales are made by six salesmen who call on customers, usually large industrial and institutional users, within 150-mile radius of Tri-City, Tennessee. Four salesmen cover the Tri-City trading area and two salesmen service the outlying territory which includes North Alabama and Georgia, Western North Carolina, and certain sections of East Tennessee.

James Briggs had believed that the company should manufacture and mix many of its own chemicals and cleaners. Mr. Basket disagreed and resisted any attempts to engage in manufacturing. However, after the death of Mr. Basket in 1952, the new vice-president and general manager, Sam Martin, yielded to Mr. Briggs' wish that products be manufactured. Various types of mixing equipment were purchased and operations began. After a few years of manufacturing it was decided to abandon it. Mr. Martin indicated that a full-time chemist was needed instead of the part-time consultant located in Atlanta, Georgia.

Organization Prior to 1958

B. C. Smith, president of Central Supply Company and principal stockholder was born in 1896 and in 1919 he became a partner with his father in a food brokerage firm. In 1937 Mr. Smith inherited sole ownership of the food business, but in 1951 he provided his son, B. C. Smith, Jr., with a partnership interest of 20 percent. B. C. Smith is also president of a local bakery and a director of a large bank in Tri-City.

Sam Martin, vice-president and general manager, was born in 1903. He became associated with Central Supply Company in 1939 after serving many years as a life insurance underwriter. Originally a salesman with the company, Mr. Martin was named vice-president and general manager in 1952.

Charles Scholar, secretary of the company but primarily engaged in sales, was born in 1916. He was employed by the Tennessee Valley Authority. After five years of service with the U.S. Army during World War II, Mr. Scholar entered the hardware business, but a year later, in

1948, he sold it at a profit and was employed by Central Supply Company as a city salesman.

B. C. Smith, Jr., treasurer, was born in 1927, and after attending Duke University he joined his father in the food brokerage business. He became a partner of B. C. Smith Company in 1951 and is active in the management of that business.

Organizational and Operational Changes

Prior to 1958, the officers of Central Supply Company were B. C. Smith, president; Sam Martin, vice-president and general manager; Charles Scholar, secretary; B. C. Smith, Jr., treasurer; and Bill Thompson, controller. At a directors' meeting on June 4, 1958, it was decided to engage the services of the Green Company, management consultants, and June 12 was set as the starting date for the first project, "Profit *and* Expense Control." The fee was set at $25 per manhour.

The consulting firm issued a report and a series of recommendations in June which proposed certain changes in organization and operations. Over one third of the report dealt with standard procedure and personnel and discussed the general principles of management such as delegation of authority, assumption of responsibility, channels and methods of communication. The balance of the report contained specific recommendations regarding the organization and operations of Central Supply Company.

The Green Company in June, 1958, suggested that the organization be changed. B. C. Smith would be president and general manager, and Mrs. Ann Southern, executive secretary. Bill Thompson would continue as controller and would assume responsibility not only for accounting and credit but also inventory control, under direction of Mrs. Sally Grass, and operations, headed by Jack Black, which included warehousing, shipping, and janitorial service.

A significant change in the organization of the company suggested by the consultants was to divide sales into two divisions, each headed by a vice-president. Sam Martin, former vice-president and general manager, would be first vice-president in charge of Division 1, and Charles Scholar, former salesman and secretary, would be second vice-president in charge of Division 2. Each vice-president would be in charge of sales promotion, salesman training, and product study analysis in his division.

In a directors' meeting in June, 1958, the board decided to accept the new organization suggested by the Green Company, and thus sales were divided into two divisions, each under a vice-president who received a fixed salary plus 1 percent override on his division's sales.

The consulting firm also suggested a change in the method of computing salesmen's commissions. Formerly commissions were figured by taking 10 percent of sales for overhead, then deducting cost of sales. The remainder was divided equally between the salesmen and the company.

The Green Company made an extensive analysis of the Central Supply Company line and divided the products into five groups based upon margin. The items having the highest margin were in the "A" group, and those having the lowest margin were placed in the "E" group. Commissions were to be figured as follows:

10 percent plus 5 percent plus 5 percent on all items marked "A."
10 percent plus 5 percent on items marked "B."
10 percent on items marked "C."
5 percent on items marked "D."
1 percent on items marked "E."

The new commission arrangements were put into effect in the summer of 1958 and accordingly new contracts were signed with each salesman.

The Green Company also worked out and the company adopted a perpetual inventory system and a more logical grouping of inventory in the warehouse.

Recent Operations

The company used the perpetual inventory system for a little over a year and then abandoned it. The reason given was that it required a full-time clerk to handle it and the cost exceeded any advantages that might result from the system. Currently, inventory is taken every quarter and requires only one day's work since items are now warehoused more logically. Items in short supply are noted daily by the shipping clerk as he fills orders.

The minutes of the annual meeting of stockholders in April, 1960, record the following statement:

> Sam Martin reviewed the annual financial statement for the year 1959 and reported a financial gain of $7,268.00, an improvement over the previous year's loss of $11,614.19. The improvement for 1959 was attributed to the discontinuance of the plan of operation as recommended by the Green Company and the adoption of a plan of operations which was in effect prior to adopting the Green Company recommendations.

In June, 1960, Buss Grey, one of the company's top salesmen, resigned to accept a sales position with a materials handling equipment company. A discussion with Mr. Grey revealed that he was dissatisfied with the new commission arrangements. Although his sales remained substantially the same in 1959, his income dropped appreciably.

B. C. Smith, in the summer of 1960, stated that the company was making roughly the equivalent of a sales discount and wondered whether or not the business should be sold, liquidated, or put on a more sound basis. He indicated that he wasn't certain whether the Green Company proposals were unsound or whether management had not fully taken advantage of the changes suggested by the consulting firm. Both Charles Scholar, second vice-president, and Sam Martin, first vice-president, felt that many of the recommendations made by the consulting firm were of doubtful value. Mr. Martin noted that the reorganization of the company left it without an active administrative head since Mr. Smith was concerned primarily with his other business interests. Mr. Scholar, in August, 1960, stated that the company, with sales of approximately one-half million dollars, should be making money. He felt that perhaps overhead was too high, that the investment in inventory was unnecessarily large, and that a sales training program was needed. He expressed optimism for the future of the company and pointed to the growing market for the products and services of the company.

In the middle of August, 1960, the case writer visited Central Supply Company for the final interview with Mr. Martin only to discover that Mr. Martin had left the company two days earlier. A discussion with Mr. Scholar revealed that the company was contemplating the purchase of Mr. Martin's stock. It was also learned that Buss Grey, who had left the company in June, had agreed to return as salesman.

APPENDIX A

SURVEY OF THE SANITARY SUPPLY MARKET*

The sanitary supply industry encompasses those firms who sell products used in the housekeeping and maintenance of industrial, institutional and commercial buildings. The most important single group is the janitor supply jobber who represents approximately two thirds of the firms and accounts for almost 80% of the products sold.

Since 1940 there has been an influx of jobbing firms in somewhat allied fields such as paper, hotel, restaurant, bar and school supply firms who have developed janitor supply departments. In 1959 there were approximately 1100 such firms who represent almost 20% of the number and who account for approximately 16% of the total volume.

More recently there has been a steady growth of cleaning contracting firms who furnish both labor and materials to maintain buildings. There are almost 1000 such firms actively engaged in this work exclusive of the window cleaners who may have one or two clients who they service. In the future, window cleaners may develop this phase of the service into a substantial volume.

Cleaning contractors represent approximately 12.5% of the total number of firms selling sanitary supplies and account for about 5% of the total sanitary supplies sold, these products having been purchased from manufacturers and resold to the user through service contracts. For the most part these purchases represent expendable products such as floor cleaners, finishes, mops, etc. The other items used—mopping equipment, floor machines, vacuums, etc.—are generally purchased locally from janitor supply distributors. Due regard for this phase of the purchasing has been made in this study.

During 1959 the sanitary supply industry sold $731,000,000 in housekeeping products. The largest single item was floor cleaners which accounted for $143,200,000. Figure 1 represents the estimated sales for 11 of the most important groups of products making up this volume.

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* Prepared by *Sanitary Maintenance*.

FIGURE 1

Gross Annual Volume—$731,000,000

Floor cleaners	$143,200,000
Floor finishes	134,066,000
Floor machinery	57,400,000
Vacuums	27,398,000
Hand tools	73,100,000
Paper products	102,200,000
Waste receptacles	21,930,000
Mopping equipment	32,895,000
Disinfectants	36,550,000
Insecticides	21,930,000
Hand soap	29,275,000
Others	51,056,000

Sales of sanitary supplies are made by the 30,000 salesmen who represent the 6100 firms in this industry. These products are sold by demonstration as opposed to point of sale purchase of similar domestic items. Sales are made to a wide range of buildings which for the most part (85%) prefer to buy locally from a sanitary supply distributor who in reality is a dealer selling in bulk quantities. Their sales to retail customers are of minor importance. Figure 2 is the 1959 estimate of sales to classes of customers.

FIGURE 2

Sales to Principal Customers

Schools, colleges, and so on	$132,580,000
Hospitals	43,860,000
Institutions	51,170,000
Industrial plants	146,200,000
Office buildings	82,665,000
Government buildings	9,565,000
Motel-hotels	22,550,000
Theaters	7,130,000
Churches	43,860,000
Auto dealers and gas stations	58,480,000
Others	132,145,000
	$731,000,000

From the results of this survey it appears that jobbers show a marked preference for national brand merchandise in the following lines: Floor machines, mopping equipment, paper products, vacuum cleaners, and waste receptacles. There is no clear-cut division in the other lines as jobbers appear to carry both.

Because the results of the survey did show a wide variation from the median gross margin in all lines, Figure 4 illustrates the variation in the margin for floor wax, both national brand and private label products.

The sanitary supply industry stands to expand substantially with the development of new schools, new hotels and motels, new hospitals, new office buildings, etc.

Owners and tenants alike are becoming more demanding in the appearance of their properties and quarters. Construction materials, particularly resilient floors insure a continued high use of sanitary supplies in the maintenance and housekeeping of the buildings. High replacement cost and high labor maintenance rates (90% of the total maintenance cost) suggest the use of the proper products with less emphasis on the price of sanitary supplies.

FIGURE 3

GROSS MARGIN OF PROFIT

	National Brand	*Private Brand*
Brushes	45%	50%
Disinfectants	40%	50%
Floor wax	40%	50%
Floor machines	40%	40%
Mopping equipment	40%	40%
Mops	50%	50%
Paper towels and toilet tissue	20%	20%
Soaps and detergents	40%	50%
Vacuum cleaners	40%	40%
Waste receptacles	40%	40%

FIGURE 4

FLOOR WAX GROSS MARGIN

Percent Margin	*National Brand Percent Jobbers*	*Private Label Percent Jobbers*
10%	4%	2%
20	2	0
30	20	5
40	45	21
50	22	40
60	3	22
75	0	5
100	4	
	100%	

Based on 1959 selling prices, the industry expects an expansion to $750,000,000 in 1960.

The typical sanitary supply distributor stocks between 300 and 1000 different items. His business has been built around servicing his trade. Normal orders received one day are shipped not later than two days following. This requires a balanced stock of merchandise. (A recent survey by the National Sanitary Supply Association indicates an average inventory of 47 days for its members.)

Products used in the maintenance of floors account for almost 70% of his business and approximately 80% of the net profit.

Because of the wide line of products sold by the sanitary supply house, manufacturers are in effect competing for the jobber salesman's time each day, in much the same manner as manufacturers compete for shelf space in a supermarket. Salesmen in this industry are generally paid for the sales made; some are on straight commission, others on drawing account plus bonus, and very few work on a straight salary.

Less than 5% of the firms engaged in this business sell over $1,000,000 per year; almost 25% have gross sales up to $50,000 annually. The average distributor grosses approximately $125,000 and employs three to four salesmen.

Jobber salesmen on the average service up to 225 accounts each. Some are contacted weekly; others bi-weekly, monthly and as seldom as bi-annually, depending upon the volume. Generally these salesmen are calling on their regular accounts once a month.

The typical sanitary supply firm is local in scope. Its territory extends

FIGURE 5

Gross Sales by Distributors

Gross Sales (In Thousands of Dollars)	*Percent of Distributors*
Up to 50	25%
51–100	20
101–200	21
201–500	18
501–1,000	13
Over 1,000	3

to a radius of 100 miles although its more active area is confined to a 50-mile radius. The average sale of janitor supplies is $40.00.

The sanitary supply distributor is a small business man. He relies on his suppliers to help him train his salesmen and to help him advertise his products. Two thirds (66%) of the firms have suppliers' salesmen address their sales meetings and 70% of the jobbers expect their suppliers to furnish them with literature to be used in direct mail advertising. Literature needed is mostly in the form of envelope stuffers since only 30% of the firms have up to date lists on stencils; an additional 20% indicate they have a list but not on stencils. Approximately 50% of the jobbers look to suppliers of national brand products to assist their sales organizations with detail men in the field; only 15% of the jobbers look to their suppliers of private label merchandise for this help.

Suppliers' salesmen are expected to call every 30 to 60 days. Practically none of the jobbers want the salesmen to call more frequently than once a month.

APPENDIX B

The Average Sanitary Supply Jobber*

What is an "average" sanitary supply jobber? How much business does he do? What size inventory does he carry? How many salesmen does he employ? How many accounts does he sell and service? How does he locate and hire salesmen? What does he pay his salesmen? In what age ranges does he find the best and most reliable salesmen? How many calls do his salesmen make and how much do they sell?

Accurate answers to these questions obviously could help any sanitary supply jobber in finding answers to some of his own problems. With this in mind, a survey on the subject was recently conducted by *Maintenance & Sanitary Supplies*. Questionnaires were mailed to 1,587 readers of the publication selected at random from the circulation list. Approximately every fourth name was selected to cover all 48 states and all types of firms from the smallest to the largest. Replies to the questionnaire totaled 246, coming from every state in the Union. . . .

When the figures from the questionnaires were analyzed and averaged, they revealed what could be a fairly accurate picture of the "average" sanitary supply jobber's business. The figures show that the "average" jobber does $252,590 in gross annual sales and that he carries an inventory of $35,470. He employs 4.2 salesmen in the average age range between 35 and 50. His firm sells and services 1174 separate accounts in the course of the year and his salesmen call on each account approximately once every 30 days.

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* Prepared by *Maintenance & Sanitary Supplies.*

Individual sales volume of each jobber was spread over a wide range. The highest sales volume reported was $2,000,000 and the lowest $3,500. The survey showed that seven firms did over $1,000,000 in sales per year, 22 firms reported sales of $500,000 to $1,000,000, 66 firms reported sales of $100,000 to $500,000, 90 firms reported sales of $50,000 to $100,000 and 23 firms reported sales under $50,000. Some 63.7 percent of all firms reporting fell into the $100,000 to $1,000,000 classification.

In reporting, 39 firms did not give their sales or inventory figures. Due to this omission, there is the possibility that the accuracy of the average figure for sales and inventories might be subject to some question. Chiefly, the omissions were from smaller firms whose figures—if calculated in the average—would conceivably bring the average figures for sales and inventories down to a lower level. Without any real basis in accurate figures, and based mostly on years of observation in the field, the opinion exists that a true average of gross business per firm might be nearer $150,000 than at the $252,930 level as shown by the questionnaire returns. The inventory figure in turn might be nearer $30,000 than $35,000.

However, there seems to be no conclusive evidence that the $150,000 figure is more accurate than the quarter-million total shown by the questionnaires. If it is assumed that there are about 6,000 actual jobbers of sanitary supplies in the U.S., an average of $250,000 per firm would indicate a gross business for the jobbing industry of about one-and-a-half billion dollars which seems well in line with trade association and other educated estimates. So possibly the $252,930 figure is an accurate average, more so than one might judge from first considerations. The possibility exists that the sales of some of our larger jobbers may have grown during recent years to a point where they could well boost the average for the entire jobbing industry to a high level.

To get back to inventory figures, these also showed a wide variation. The concerns with smaller sales volumes carried a larger inventory in proportion to their sales than did the larger firms. However, there was no direct relationship between sales and inventory apparent from the results, but an average of both figures indicated that the "average" jobber turned his stock over slightly less than eight times during the course of a year. These figures might be the most misleading of the entire survey, however, because one firm doing over a million dollars worth of business indicated that it turned its stock over 10 times during the year while a firm with less than $50,000 annual business reported that it turned its stock over approximately 28 times.

How does the "average supply company" turn over its stock? Apparently salesmen are the backbone of any sanitary supply operation for the results of the survey indicated that 76.1 percent of all business is acquired by direct solicitation by salesmen. Direct mail accounted for only 15.8 percent of business and newspaper advertising accounted for even less—only 8.1 percent of the total. Thus, it must be agreed that the direct selling salesman is the mainstay of the entire operation of selling maintenance and sanitary supplies and equipment.

Locating a good salesman seems to be the critical problem of the business. The questions on salesmen and selling had more comments written on the margin than any other series of questions. One commented that he located salesmen "any way he could get hold of them." Another inquired "Good question, how can we?" The best comment was from one jobber who stated that "we raise them from childhood." Many commented that it was a "hard," "difficult" or "tough problem."

There apparently is no one good method of locating salesmen. The replies indicated that 45.5 percent of jobbers located new salesmen through contacts in the field. Advertising in newspapers accounted for 34.8 percent of the new salesmen, employment agencies accounted for 15.5 percent and high schools and colleges accounted for only 4.0 percent. The locating of good salesmen thus remains the jobber's single biggest problem.

Based on sales, how can the "average" jobber decide on how large a sales force is needed. Based on the "average" of 4.2 salesmen working for our "Average Supply Company," which is doing approximately $252,930 in sales annually, we can assume that the house is entitled to 60 percent for operating expenses and owners' commissions (owner or owners should do more business than salesmen). Thus, we can conclude that approximately $126,465 in business should be allotted for the sales force. Based on an average of 4.2 salesmen, there should be approximately $30,110 worth of business available to make it worthwhile to hire an additional salesman. Allowing for commissions and salary for the salesman of approximately $4,000 to $5,000 annually, the salesman should bring in at least $25,000 in business to the house to make him a profitable venture.

The "Average Supply Company" business is based on 1,174 accounts. These are, obviously, both large and small and good and bad. Again we will assume that 50 percent of the accounts are house accounts. Thus, 587 accounts are house accounts and 587 are available to the sales force. On this basis, each salesman will have approximately 139 accounts to service. The "average" account is called on once every 30 days. On this basis, the salesman will be required to make 1,668 calls a year to see each account 12 times. Working five days a week for 50 weeks, the salesman will have 250 working days. Thus, he will have to average about 6.6 calls per day. This means that he will have to average approximately $120.44 in orders per day, or $18.24 in sales per call. Accounts that consistently fall below this figure are not profitable to the salesmen or the house and should eventually be dropped, but only after careful study. New salesmen sometimes manage to secure business that has evaded other salesmen from a concern, but new salesmen will soon be discouraged by a full file of such small accounts. A few good house accounts would do much to raise their morale during the early days when doors regularly are being slammed in their faces.

Are all men good salesmen? One of the survey questions related to the average age of the most reliable salesmen. The replies indicated that 63.9 percent of the jobbers felt that the 35–50 year age group made up the most reliable group. This was followed by the 25–35 year age group where 17.3 percent of the replies indicated that group to be the best. Only 13.4 percent indicated that the 50–60 year old group was the best. Of the 246 replies not one indicated that the 18–25 group or the over 60 group classifications were considered a reliable group. Unfortunately, the survey did not go further into this question to find out if the jobbers flatly refused to hire men in these age groups, or simply felt them to be unreliable.

Would the "Average Supply Company" be wise in expanding, or is the operation strictly a one place or "main office" operation? Only 17.8 percent of those surveyed indicated that they operated branches, while 82.2 percent indicated that they did not operate branches. The "Average Supply Company" would operate two branches based on an average of the group that replied "yes." The largest number of branches indicated was six while the majority indicated that they operated one branch.

Another problem facing the "Average Supply Company" was that of offering premiums or sales gimmicks. If "Average" follows the trend of the survey, it will not offer any such sales inducements for 86.1 percent of those surveyed indicated that they did not offer any premiums while only 13.9 percent indicated that they did. When such a large percentage do not offer any sales inducers, it might indicate that they have found that such premiums do not pay. The trend seems to be away from use of premiums.

Should "Average" have a minimum order? Again, the overwhelming indications of the survey were that very few have such a minimum order. Only 16.1 percent indicated that they did have a minimum order while 83.9 percent indicated that they did not. While the pros and cons still rage in the industry on this problem, the majority of jobbers have apparently not resorted to this measure. The average minimum order was $11.09 and ranged from a minimum of $5 to a maximum of $25. Several indicated that there was no minimum involving money, but a restriction on quantity such as a minimum number of pounds or gallons.

Should "Average" consider exhibiting at local trade shows? Only 27.9 percent of those surveyed indicated that they exhibited at trade shows while 72.1 percent reported that they did not exhibit. The "average" attendance at such trade shows was every seven months, with the range from 15 to 20 a year to every three years. When asked if the shows paid off in results, answers were somewhat evasive with 22.2 percent indicating that they were of doubtful value and 16.7 percent indicating that they thought that such shows did not pay. However, 61.1 percent indicated that local shows did pay a dividend.

Should "Average" advertise its services to the world, or should it rely strictly on salesmen to spread the name. The survey indicated that 7.6 percent of jobbers did no advertising at all. Of those who advertised, however, the largest single means of advertising was telephone directories where 58.3 percent of all jobbers indicated that they advertised. Second in line were local directories with 15.7 percent and third were newspapers with 9.3 percent.

Direct mail and trade journals accounted for 4.0 percent each and miscellaneous items such as school yearbooks, house organs and others accounted for 1.1 percent. Apparently telephone directories are considered the "best buy" in advertising for the jobber as his name is listed in an accessible place and available to new customers.

Finally, should "Average" go to the expense of publishing a catalog for use by salesmen and others? Again, most of the jobbers surveyed indicated that they did not publish their own catalog, for replies indicated that only 38.8 percent published their own catalog. The cost of producing such a catalog averaged approximately $1.16 per copy and they were issued on the average of every 18 months. While not issuing their own catalog, 53.8 percent of the jobbers indicated that they requested insert sheets from manufacturers for use in selling. As for the manufacturers co-operating with the jobber, it was almost overwhelmingly in favor of the manufacturer—93.4 percent of the jobbers said that the manufacturers were cooperative in supplying the dealers with insert sheets or photographs of the products that they handled.

These are only a few of the problems that face the "Average Supply Company" in its daily operations. However, from the figures in the article, it might be possible for all jobbers to use "Average" as a yardstick in judging their future operations and future decisions. While all survey figures have to be generalized, it is the hope of this survey that these generalizations can be applied to the operation of the average reader's business and help him in operating it.

The Blue Eagle Refinery[*]

On this bright April morning in 1960, Bob Whitley[1] was startled by the bell of the coffee cart as it sounded outside his door. He had been wondering why he had not received any replies from the letter he had written to his friend, Leo Black, director of Industrial Relations of the Blue Eagle Oil Company refinery on the Gulf Coast—one of the largest refineries in the nation. Blue Eagle, one of the major oil companies, had been a leader in developing the oil fields of South Texas. They had an outstanding reputation for dealing fairly with their employees. In August, 1959, there had been a long-expected announcement that Blue Eagle would be merged later with the world-wide Elixer Oil Company. A national consulting firm had made a thorough study of the two companies and consolidation was the expected result. People in the know had recognized this move as a typical step in the petroleum industry at this time. Reputedly there was much tightening-of-the-belt in all companies. Bob recalled that last October Leo told him that a group from the New York office had been working with some of the men at the refinery on a staff study to determine the personnel requirements of the big Blue Eagle refinery.

Bob's train of thought was interrupted by his secretary, Mary Kennedy, who said, "Mr. Whitley, the coffee cart is here. May I get you a cup of coffee now?"

"The usual, please, Mary," Mr. Whitley replied, which reminded him how successful that plan had been in reducing time lost at coffee breaks. The coffee cart was rolled down the halls every morning between 10 and 11, and coffee was served free to everyone. Bob Whitley patted himself on the back for the acceptance his idea had gotten from top management.

As he drank his coffee he reminisced again on the story Leo Black had told him of the consolidation of the Blue Eagle Oil Company. Things seemed to move rather smoothly from the time the general announcement was made in August, 1959, until mid-January, 1960. While there was some feeling that there might be some changes in status and job assignments, each employee seemed to feel that his job was secure. Blue Eagle had an outstanding record of never having fired any employee who was making an effort to do his job.

Late on Friday afternoon, January 22, 1960, the results of the staff study made at the Gulf Coast refinery became known and the chief of Engineering was told that the bulk of the research function which had formerly been assigned to that refinery would be transferred to New

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[*] Prepared by Ike H. Harrison, Texas Christian University.

[1] All names have been disguised.

York. This decision resulted in a surplus of some 56 people. Of these, 25 were mechanical engineers, 8 were chemical engineers, and the others were draftsmen and support personnel of the research department. The professional people in the organization had been highly screened by Leo Black and his staff. Most of them represented the cream of the crop of the engineering graduates of two years ago. They had been recruited from the top schools of the South and the Southwest and were representative of the best men in their graduating classes. Most of this group had two years, or less, service with the company. The fact that they were highly regarded by the company was illustrated by the fact that at the end of six months they had been given a merit raise of $35 a month, and at the end of another 12 months they had received a second merit raise of $35 a month. Two of the group had 10 years' service.

Early on Monday morning, January 25, the director of Engineering called in a group of 15 men, who worked in one department, and told them the results of the staff study. The research function was to be transferred to New York. Their jobs were to be terminated on March 1, 1960! In a 15-minute period he assured the group that this decision had been made necessary by the consolidation of the two companies and a resultant overage of research personnel. This action represented no dissatisfaction on the part of the company with the services of any one of the individuals. Further, the company was prepared to do all in its power to assist each man in finding a job elsewhere. This same story was repeated to others in small groups, until all 56 men had been notified of the action.

Bob Whitley remembered that Leo Black had told him that all 56 men were in an apparent state of shock when they got the news. Blue Eagle had never fired a person before, and each man had built up a feeling of job security.

In attempting to assume responsibility for the employees that they had sought so ardently just a few years before, the staff at the refinery made every effort to assist the 56 men in getting satisfactory jobs. In accordance with approved company policy, early retirement at age 55 was offered to employees of the company. While only a few of this group qualified for early retirement, this liberal plan had been eagerly accepted by many of those eligible in other departments. In fact, it was accepted by far more than the company had anticipated would ever consider the plan.

Blue Eagle knew that there had been a high demand for the services of people trained in the engineering fields, and felt that the problem of placing the 56 men was one of making the availability of these men known to other employers. Leo Black was well known in professional personnel and industrial relations organizations and in the American Petroleum Institute. By contacting his associates in these professional organizations, some 100 companies were notified of the availability of these men. Bob Whitley knew that he was one of the many people contacted.

Blue Eagle made stenographic assistance available to the 56 men to help them in the preparation of data sheets and résumés of their training and experience. Company photographers were available to make pictures for the résumés; the résumés were reproduced on company machines and equipment at company expense. As offers began to come in, the men were given time off to go to other locations for interviews. They averaged between three and four trips each. Some 40 companies came to the refinery to interview the men. Interview rooms were set up in the offices. While most of the interviews were held week days, any company that could come during the weekend was encouraged to do so. Blue Eagle advanced funds to the men for travel to other locations for interviews. The men were given time off for interviews at the refinery, or for trips to other localities.

The first week after the announcement, the employees who had been given notice of termination of employment on March 1 were somewhat stunned. They had felt that this company was one that would provide stable employment in the future as it had in the past. As the days wore on, the group of 56 employees became a rather closely knit group. They formed a club to discuss their problems, which had regular attendance of from 20 to 25. They became more interested in each other as a group than they had been before. Yet as a group they were very depressed. The fact that each man would receive separation pay on March 1 was not especially stimulating. The separation pay was based on the age of the individual and the length of service with the company. The minimum was two weeks' pay.

By the end of the first week, February 1, one of the displaced employees had found a job with another company. The fact that he received a salary boost of $125 a month gave a new outlook to the rest of the employees.

The companies that learned of the availability of the 56 men took different steps to contact the employees. Of the 100 companies who expressed some interest, 40 came to the refinery for interviews. Others invited the men to come to their headquarters, while some wrote letters.

Bob Whitley pulled out his file on Blue Eagle and reviewed the letter he had written to Leo Black. In the letter he had invited any of the the men interested to submit a résumé to him. He had stated that his company, which was one of the leaders in the petroleum field, was seeking able men with engineering training. Leo Black had told him that he would post this letter on the bulletin board where notices were given to the 56 employees.

Leo also had told him that there was considerable interest in the 56 men. The companies that expressed interest in these men ranged from oil field machinery manufacturing companies, to process sales organizations, to chemical companies, to petroleum companies, to data processing manufacturers, to such firms as Eastman Kodak. The companys' locations ranged from California to Michigan to New York.

Earlier this morning Bob Whitley had received a call from the director of research of his company indicating that they were in need of a chemical engineer in their refinery and could use one next week. As Bob finished his coffee he asked his secretary to get Leo Black on the phone. During their conversation, Leo pointed out that all 56 men had been placed; that there had been much apparent demand for them; that most of them got salary increases. One man had nine job offers. Most got four to five. Most men went into sales. Only four were placed in refineries. Leo also said that he felt the 56 men did not hold any bitterness toward Blue Eagle because of the all-out effort that was made to place them in other jobs. Leo indicated that he had posted the letter Bob had written. He, too, expressed some surprise that Bob did not get any applications.

Bob closed his conversation with Leo by saying, "The next time you come to Houston, I will take you out to the house in my new Volkswagen. I am getting about 30 miles to the gallon on the runs from home to the office. You know we have discontinued our policy of providing company-owned Buicks for our executives, but I can really fly that V-W."

APPENDIX

BOUNCED BOSSES: MORE EXECUTIVES START JOB HUNTING AS MERGER PACE HOLDS AT RECORD

They're Usually Shunned by Executive Recruiters and Often Find Age a Barrier

Temptation: Lower-Pay Jobs

by Norman C. Miller, Jr.[2]
Staff Reporter of *The Wall Street Journal*

In San Francisco an unemployed former $20,000-a-year treasurer anxiously scans job listings at a state employment service office. In a Chicago suburb an ex-vice president works worriedly on the third hundred of a series of letters to firms he hopes can use his services. In New York a former general sales manager, now a magazine advertising salesman, ruefully contemplates his cut in annual income from $25,000 to $12,000.

All these ex-executives, widely scattered as they are, share a common lot: They can't find jobs as bosses. Their sudden ousters from long-held executive posts stem from corporate reorganizations, not incompetence. But their age, their own bewilderment at their plight and the complexity of executive hiring systems have thus far posed a three-decked barrier to efforts to regain their former lofty status.

Although no one keeps tabs on the number of unemployed executives, talks with more than a score of executive recruiters and management consultants turn up a nearly unanimous opinion that the number of unemployed executives is growing.

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[2] *The Wall Street Journal*, Vol. XXVI, No. 32, Tuesday, August 16, 1960.

A New York executive recruiter reports inquiries from unemployed bosses have tripled in the past two years. A Chicago executive job counselor, who advises job-seeking executives, says about 25% of his clients are unemployed, compared with a "normal" average of 15%. The rest are employed but are hunting better or more agreeable posts. A Los Angeles employment official reports "hundreds" of executives out of work due to cutbacks in aircraft manufacturing. "Heads have really rolled around here," he says.

Reasons: Mergers eliminate many top jobs. Rapid technological advances drastically curtail demand for traditional products of many industries, causing retrenchments. Even when outright dismissals don't result directly in these cases, changes often spawn office intrigue, policy rifts and personality clashes which lead to executive ousters, management consultants say.

Six-Month Search

But aren't such bounced bosses quickly snapped up by companies proclaiming a dearth of management talent? Many are, but by no means all of them. "A top executive is fortunate if he finds what he wants in six months," says William Clark, a New York executive recruiter.

The plight of ex-executives, unpleasant as it may be, should be of more than passing interest to active bosses. New owners are not always respectors of seniority and past performance. "A man should always have an anchor to windward," counsels a management consultant. "When he sees these things happening to others he should be thinking: What would I do if this happened to me?"

For mergers continue at a record clip and some of the biggest consolidations are yet in the offing. The Federal Trade Commission, which tries to keep track of significant mergers, counted 525 instances in which merger talks were either started or completed during the first six months of 1960. That was equal to the pace of 1959, when the agency counted 1,050 cases in which merger negotiations were begun or were completed. Several more are under consideration among railroads. And in the airline business, plans for mergers have been announced, between United Air Lines and Capital Airlines and between Trans World Airlines and Northeast Airlines, which might touch off marriages by other carriers. Says a veteran vice president of a smaller airline about to be merged: "Almost all of our executives are going to go."

The shock of a dismissal leaves many a bounced boss bewildered as well as embittered. Notes a jobless executive: "The thing a man has to battle more than anything else is a sense of not belonging. You've been a key part of an organization for years, and it's a real blow to your morale to be let out."

It Happens Fast

And although most ousters have a gracious appearance—they're usually termed resignations—appearances can be deceiving. For example, not long ago the entire management of one electronics company was fired by telegram by new owners. "Most executive dismissals are abrupt, although precautions are taken to make them look like a carefully considered move on the part of management and the individual," says one employment specialist.

Moreover, for the average medium-salary unemployed person, finding another job is a clear-cut matter of making the rounds of company personnel departments; employment agencies abound that are anxious to lend a hand. But few agencies cater to the executive trade. Ex-executives face an artful chore which most of them are sadly equipped to handle.

"Most of these men are babes in the woods when it comes to getting jobs," declares Bernard Haldane, president of Executive Job Counselors, Inc., New

York. "There isn't anything as stupid as the average business executive trying to sell himself," says Sidney Edlund, another New York counselor.

Many ex-bosses have little idea how to write a résumé which will entice an employer, say job experts. Some specialists advise ex-executives to write "reports" analyzing their past experience, forgetting the standard résumé format. But this can be carried to extremes, as in the case of the ex-sales executive who explained at length how he had successfully licked his alcohol problem 15 years ago.

A short, but successful, letter employed by a former purchasing agent: "I have been signing checks on a single-signature basis for $1.5 million per year. I would be interested in exchanging references." This succinct statement netted him interviews from all seven of the companies to which he wrote, and, in short order, a job.

Many ex-executives, who pride themselves on past success, have a hard time accepting rebuffs. "You get a few rejections and it's darn hard to hold your head up," admits an unemployed boss lately relieved of his $25,000-a-year post in a retrenchment. "It's the wrong attitude to go in and talk to someone exuding failure. No one wants to hire someone like that, but one of the hardest things to realize is that nothing is wrong with you."

It's plain that job-hunting at executive levels is no job for an amateur and many ex-bosses are just that. Employment specialists note that experienced job switchers usually recognize the earmarks of a potentially untenable position and, if possible, move on before being let out. On the other hand, long-time executives are more likely to hope they can hold on to their jobs. "Almost without exception, they are rudely disappointed," says John Powers of Cadillac Associates, Inc., one of the few executive employment agencies.

Such men often have worked their way up in one company and have never looked for a job. With little idea of job-hunting techniques, unemployed bosses also find themselves outside most executive hiring systems. According to Executive Manpower Corp., a New York consulting firm, companies fill more than half their posts by promotion and rely greatly on executive recruiters when they do go outside for talent. And recruiters hardly ever choose ex-executives for their clients. "About 99% of the people we get for positions are already employed," remarks Hallam B. Cooley, vice president of Handy Associates, an executive recruiting firm.

To remain on equal footing with employed job rivals, ex-executives can't appear too eager for a job, even though unemployed. It's all right to be "available," say employment specialists, but anything so gross as asking for a job is out. "It's a nerve-racking job," concedes a job expert, "but an executive has to keep his dignity or he is through."

What this boils down to is a sort of subtle sell. But before ex-executives can make their muted pitch they have to get to the right people. "You've got to hit a top man, the president if possible," says a sacked personnel manager who discloses that personnel officials seldom have authority to hire executives above the $15,000 level. "They have to get to someone in top management," agrees Clark Ryder, a Los Angeles employment official. "Often no one else in the company will know of plans to hire an executive."

Reaching the Top

Getting to top officials can be a tough chore. Most ex-executives rely on passing word of their "availability" among friends and business acquaintances, but this doesn't always work. "That's the only way I know how to do it," says one ex-executive, but after two months of waiting for an introduction he glumly reports little success. And an employment expert observes: "Friends don't really know their qualifications and can get them into embarrassing positions."

When ex-executives do maneuver themselves into job interviews, they have to know when to stop playing cagy. "The executive has to sell his mind," says Richard D. Gleason, a Chicago executive counselor. "Companies aren't interested in what the man has done, but in what he can do for them," remarks a management consultant.

One ex-personnel manager is convinced a blunt approach will eventually get him back on the other side of the desk. He opens each interview by saying: "If you want a detail man or a yes man for this job, I'm not your man. If you want a man who is friendly, but aggressive and at times a little impatient, I'm your man." He's nobody's man yet, but he is confident his frankness will be rewarded.

In an interview, most unemployed executives falter in treading the fine line between underplaying and overplaying their hand. "They talk too much and try to overly impress the employer," claims one employment agency official. But a company executive counters: "They sit in that chair, don't tell me anything, and dare me to find a reason to hire them."

An ex-executive's age is often a painful handicap. Most former bosses are middle-aged, and companies with extensive training programs are often reluctant to hire men past 35. "Age is everything," contends a 54-year-old former boss who has been job hunting unsuccessfully for 21 months.

"Usually an Excuse"

Employment officials disagree on this factor's importance. "Age is generally only an excuse for not hiring a man," says Mr. Gleason. "The reason is that he fails to sell himself." Many job experts, however, advise older ex-executives to concentrate on small firms. "We are practically never asked to secure a man who is over 50," says Mr. Cooley.

The few job counselors advising ex-executives are mostly headquartered in New York and Chicago. Unlike employment agencies, they usually don't seek out jobs for their clients but drill them on the techniques of job-finding and résumé-writing. One such service was started by Mr. Gleason, a former General Electric Co. personnel official, in Chicago six years ago. He takes only 200 or 250 clients a year, turning down some whose "marketability" is questionable, and charges $500 for his service. His firm also offers counseling to groups of eight or ten men at $250 per person. Most of his clients are still employed, though angling for a change.

Employment agencies find executive placement unprofitable because it takes so long to line up a middle-aged former boss with a job. Robert Schwarz, president of the National Association of Employment Agencies, says none of the group's members specializes in placing high-salaried men. "I tried the employment agencies and found that nobody wanted to talk to a 48-year-old man," recalls a controller ousted in a merger.

Most trade and professional groups shy away from close involvement with job-hunters, but a few private organizations, such as the Sales Executives Club of New York, sponsor job-hunting services. The club has expanded its service to non-member sales bosses and now has 1,300 résumés on file, all but about 10% of them from men who were forced out of their jobs, according to Henry Astwood, director of the job service. Oddly, ex-sales executives don't seem any more adept at job hunting than other former bosses. "Of those 1,300 résumés 90% don't have five cents worth of sell," says Mr. Astwood.

Mutual Encouragement

In at least one instance, bounced bosses have banded together to try to solve their problems. In Berkeley, Calif., Ralph Moore of the state employment department became concerned about a year ago about the number of former top officials who were registering for unemployment compensation. Most of them seemed completely demoralized, he recalls, so he invited them to get together to talk over their difficulties.

Out of such informal gatherings has developed a weekly meeting group (with transient membership, of course) which dubs itself Experience Unlimited. Every Friday the 20 or so current members meet to swap job-hunting tips.

About 120 men have joined Experience Unlimited for varying periods in the last year. Only about 30 got jobs through the group but members are enthusiastic. "It's a wonderful morale booster," says a current member. "It lets you know that other capable men are in the same boat through no fault of their own."

Fortunately, most ex-executives are financially able to ride out a lengthy period of unemployment. Employment officials say most ousted executives receive about three month's severance pay, and presidents get up to a year's salary. Some bosses with contracts get even bigger settlements.

Nonetheless, ousted bosses have financial worries. For one thing, they often lose substantial pension benefits when sacked, and they usually can't recoup these losses even when they find another job. A long period of unemployment can also cut heavily into their savings.

In such circumstances the temptation to accept a low-level job offer is strong. Many ex-executives frankly admit they're ready to take the first job that comes along after a few months of fruitless searching. A job counselor notes: "When a man has been out of work for six months he begins wondering about himself and can get pretty upset over it. It takes guts; he has to keep calm and not jump at the first Grade B job he is offered just to shut up his friends." Warns another employment official: "If he drops back too far in the corporate hierarchy he may hurt himself and never be able to regain stature."

part IV

EVALUATE

Horton Woolen Mills, Inc.[*]

Policies of Management in Response to a Succession of Economic Pressures

Could this really be his last day at Horton Mills? James Watson could hardly realize on July 16, 1960, that his years of close involvement with the progress of Horton Woolen Mills as the industrial engineer were coming to an end. He had moved to the job in 1954 directly from the management consulting firm which had helped to modernize the mill and had instituted and gradually expanded after 1949 a new—and, for the time, revolutionary—incentive premium pay plan for production workers.

Watson's education included an engineering degree and a graduate degree in business administration, specializing in production—both at leading institutions. His previous experience, including that with the consulting firm, had been varied. His decision to change employment in 1960, at the age of 47, was motivated primarily by his evaluation of the greater potential provided by the new position—in a neighboring state but in a different industry. He expected to move soon into a responsible line-management position.

In leaving, however, Watson felt pleased that he had been able to contribute something to the overall task of keeping the mill in business, as a unit among the rapidly dwindling number of woolen mills operating in New England.

In a staff position he was primarily responsible for making the new incentive plan work as smoothly as possible by keeping production standards as up-to-date and significant as practicable. He had responsibility for recommending job improvements to those in charge of line operations and the principal responsibility for labor cost "control," for analyzing with line supervisors each week all fall-downs or failures to attain standard performance. He characterized his job as looking for new ways to save pennies and felt it inevitable that he should be considered by his colleagues as something of a "needler."

The Woolen Industry

Keeping a firm in business in the woolen industry during the period after 1946 impressed Watson in 1960 as being no mean accomplishment. During 1959 Horton Mills prepared a brief for a wage arbitration which presented numerous details concerning the industry's difficulties. Most of the data included both worsted and woolen mills in a single industry. (The two fabrics differ primarily in the hardness and smoothness of the finish of worsted—usually found in men's suits—as opposed to the softer nature of woolens.)

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[*] Prepared by Vern H. Vincent, West Virginia University.

The rapid decline of the woolen and worsted industry in the United States following 1946 was reflected in the following data selected from various exhibits presented by the company:

TRENDS IN THE WOOLEN AND WORSTED INDUSTRY, 1939–59

Date	*Production (Millions of Yards)*	*Number of Mills Operating*	*Number of Workers*	*Looms Operating*	*Mill Liquidations*		*Organized Workers Employed*
					Firms	*Employees*	
1939	360						
1946	604	543	166,908		2	450	100,000
1950	458			44,670	17	3,900	
1952		462	111,436		33	17,500	56,000
1953					29	10,700	
1954	284				41	20,000	
1955	317				37	8,050	
1956	325				24	8,250	
1957	287	329	66,458	21,826	14	5,400	25,000
1958	270						
1959		266	64,957	14,056			21,000

The argument in the company brief attributed the decline in the domestic woolen-worsted industry after 1946 to (1) the drastic change in consumer taste (from the prevalence of insulated or warmer houses and automobiles and the move to outdoor and suburban living) to lighter-weight and more casual fabrics made possible by synthetics—unblended woolen fabrics being poorly adapted to lightweight construction, (2) the availability of cheaper synthetics "coincidentally with the high wool prices," and (3) the increase in imports related to the reduction in tariff protection. A union witness suggested, also, that the types of woolen fabrics especially susceptible to all of these forces were those used in heavy outer garments—meltons, mackinaw cloth, and velours—specialties in New England and, of course, in Horton Mills prior to 1953. He cited the loss of business also in auto and furniture upholstery, in the trend to lighter blankets, and even in the use of less wool in military uniforms.

The shift of consumers away from wool was illustrated also by United States consumption figures: Wool declined from 4.8 pounds per capita in 1947 to 1.9 pounds in 1958, while synthetics, other than rayon and acetate, increased from 0.4 pound to 3.3 pounds. Thus the major impact of the consumers' tendency to spend less on clothing was felt by woolens. They spent only 40 percent more for clothing in 1958 than 1946, although total personal consumption doubled.

Company spokesmen held that the advantage of synthetics over wool arose from the more stable cost,[1] their extensive facilities for research and a high rate of expenditure, and consumer preference for light-weight fabrics.

In the arbitration hearings the company brief stressed the importance of the moving of New England mills to the South after 1946. Union spokesmen acknowledged the movement but considered it less significant, alleging that mills in the South were also beset with difficulty.

The company stated that the full strength of the movement to the South, and the resulting severe competition for New England, was not manifest in woolens until after 1945. They compared the shock to that felt by the New England cotton mills in the 1920's and 1930's.

The company brief illustrated the impact on different regions of the decline in the woolen-worsted industry in the United States, as follows:

REGIONAL CHANGES IN THE NUMBER OF WORKERS AND MILLS, 1946–59

	1946		*1952*		*1957*		*July, 1959*	
Region	*Workers*	*Mills*	*Workers*	*Mills*	*Workers*	*Mills*	*Workers*	*Mills*
New England....	104,175	285	68,586	290	32,841	186	32,946	156
Middle Atlantic..	38,050	155	21,019	90	11,258	54	6,580	38
Southeast........	12,100	34	14,765	40	16,568	51	21,971	50
Great Lakes.....	8,150	45	4,791	31	8,291	22		
Pacific..........	2,133	13	1,597	7	1,448	8	3,460	22

It was stated, also, that in the United States 292 mills employing 97,681 persons had liquidated, that a negligible number of these were southern, and that 90 percent occurred in New England and the Middle Atlantic states. The statement cited a 20 percent unemployment record in Lawrence, Massachusetts, even in "boom" times and alleged that the average age of employees in the textile industry was increasing rapidly as younger workers avoided it as a rule.

The last point was expanded in 1960 by the personnel director, who stated that most recruits to the mill were coming from nearby communities where woolen mills had recently closed and who illustrated the advancing average employee age by the trend in cost of group life insurance per month per $1,000 of coverage: 1948–56, a gradual increase from $0.85 to $0.88; then rates of $0.92, $1.00, $1.01, and $1.08, as a trend in the period 1957–60.

Company witnesses described imports as having risen from negligible quantities in the early postwar period to an annual rate of about 11 percent of domestic woolen-worsted production of apparel fabrics in the first quarter of 1959. The *ad valorem* import duty was reduced to 25 percent

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[1] In woolens the material cost, averaging about 50 percent of selling price, was described as being highly volatile, wool varying from $0.50 to $3.75 in cost per pound during the period 1934–53; labor and overhead costs were stated at 25 percent and 20 percent respectively.

in 1947 with the added provision that the rate might be increased to 45 percent by administrative action if imports should become excessive as defined at 5 percent of domestic production over all categories. This provision went into effect for the first time in 1956, and each year through 1960 the tariff was increased by similar action taken during the year immediately after the imports to date had reached the specified figure. Regarding the impact of even a small percentage of imports on an industry, Professor Seymour Harris, economist, stated in 1958 (among other points):[2] "There is a heavy concentration [of imports] in certain segments of the industry, and this, therefore, destroys certain segments." Mr. Harris offered evidence in another connection that most foreign woolen mills competitive with American mills were generally much less modern and productive technologically. (Imports, primarily from Japan, were acknowledged to have driven Horton Mills out of their traditional lines after 1953.)

In general, the company argument treated the higher wage rates in organized Middle Atlantic and New England mills as an important factor favoring other regions in the competition for a declining total market. It presented regional differentials in average straight-time hourly earnings for production workers in wool yarn and broad-woven fabric mills as follows:

REGIONAL DIFFERENCES IN AVERAGE STRAIGHT-LINE PAY, 1946–57

	April, 1946	*April–May, 1952*	*September 1957*
United States	$0.94	$1.45	$1.48
New England	0.97	1.50	1.51
Middle Atlantic	0.92	1.47	1.64
Southeastern	0.79	1.19	1.32

They described the 1957 rates, on a comparable basis, at Horton Mills as $1.76. They explained that these figures did not include holidays, vacations, and other fringe benefits (held to be much higher than average in the North), which during Horton Mills fiscal year ended November 30, 1958, had amounted to $0.2749 per hour. They alleged that the Middle Atlantic rates were influenced to a misleading extent in 1957 by the wages of one firm which required unusually skilled workers. Also, they explained that the New England average was held down markedly by 1957 as a result of the movement of mills to northern New England where lower wage rates prevailed in the industry.

Union testimony questioned the significance of these wage differentials. The 1957 average wage of $1.76 at Horton Mills was challenged particularly on the basis that a large part of the differential resulted primarily from the extra production from the incentive premium pay plan. The company countered with evidence that 1959 figures showed that the incentive premiums amounted to only $0.104 per hour when spread over all of their production workers, and, also, that by 1959 such plans were rather general in the industry anyway—used perhaps by 40 percent of the firms. (It was explained that at Horton Mills 48 percent of production employees were on the new incentive plan, that 28 percent were paid hourly wages, and that 24 percent were on piece-work rates.)

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[2] Hearings before a Subcommittee of the 85th Congress investigating the U.S. textile industry in 1958.

Union testimony held that obsolete facilities in old New England mills and an uninterested attitude on the part of their management constituted the major handicap. They placed on exhibit an article written by a former personnel director of the American Woolen Company, which held that physical obsolescence, even around 1951, placed New England mills under a cost handicap of at least seven cents a yard. The writer largely absolved union wage rates of blame for the difficulty in New England mills and cited the unwillingness of industry leaders to experiment with new fabrics and new ideas. In this connection a union witness told of a statement made to him in 1946 by an executive of American Woolen Company at a conference set up by the union and management to explore the potential impact of synthetic fabrics: "Gentlemen, I spent my lifetime in the worsted industry, and when the day comes that I have to dilute a woolen fiber with a synthetic fiber, that is the day I want to get . . . out of this game."

However, union spokesmen had high praise for the modernization and adjustment program carried out by Horton Mills after 1946.

In connection with this particular exchange it was important to the case that in 1954–55 American Woolen Company (a giant producing 20 percent of industry yardage in 1946) liquidated its 25 mills—even after a 1954 negotiated wage decrease of $0.095 an hour. The firm disappeared in a merger in 1955.

The testimony of a union witness was quite caustic as to the management of American Woolen Company:

> Suffice it to say that the American Woolen Company represents a classic case study in backward management which finally ended up by being liquidated through the auspices of financial manipulators to take care of the losses the backward management suffered through its own deficiencies.

American Woolen Company was until almost the time of its liquidation a pattern-setter for New England union textile wages. A speech made by Francis W. White, president of the company, in Lawrence, Massachusetts, in January, 1952 (and quoted in the local paper in full), reflected his attitude toward many of the points raised in the union testimony in the Horton Mills case more than seven years later. He explained that the depression in the woolen and worsted industry actually began in 1924 and that his firm liquidated half of its plants during the 1929–39 period. He admitted that his firm had made a good *normal* industry profit of $11,851,082 during the year ended October 31, 1951—roughly 5 percent of sales—but he added: "We cannot depend upon war or the preparation for war to maintain our solvency and our existence."

He challenged critics of the management by saying that his buildings were "not as modern or efficient as the buildings we shall build in the South [if forced to do so], but, other things being equal, they will do well enough. Over the last 25 years we have disposed of the buildings that were inadequate and concentrated our production in the more efficient buildings."

Mr. White said his firm was making blended fabrics and would make more except for the existence of overproduction in such fabrics already and because his prices would not "come within a mile of Southern competition." He said the wage differential came to a very significant amount but that more important was "the amount of work that employees gave for that wage."

He saw unit cost reduction as absolutely necessary to his firm's remaining in New England. He committed his firm to cooperating fully toward remaining competitive: "Greater productivity on the part of our machinery and on the part of our workers will accomplish this vitally important unit cost reduction in our northern mills." This was crucial, he declared, because, "When all is said and done, our competition is based almost exclusively on price."

The union version of liquidations as disclosed in the 1959 arbitration testimony differed sharply with Mr. White's 1952 speech: ". . . once the J. P. Stevens Company got control of the M. T. Stevens Company, they liquidated every union mill [they had] in New England" with the exception of one.

The witness was suggesting more than union-breaking: a step toward industry concentration. He alleged that Textron acquired the whole American Woolen Company for the purpose of completely liquidating the mills, not concerned at all with trying to operate them, striving rather for a "tax bonanza."

The union attitude obviously was influenced by the fact that the liquidation of American Woolen Company was a major factor in the decline in union membership among workers in the woolen-worsted industry from 56,000 to 25,000 during the years 1953 through 1957.

The same witness gave other examples of management decisions to cease operations. One of these served better to illustrate the position of management having a mill ready for either complete rebuilding or a quiet death. He said the "company" explained to union leaders that there was nothing they could do to save the mill, a plant which then employed about 1,400 workers:

> Our machinery is housed . . . in 26 different buildings. We could go out and buy the latest machinery available and we'd still have an obsolete mill. . . .

We can't see our way clear to tearing down the physical structure of this mill and putting up a new plant and then putting up new machinery which is too much of a capital expense and we are not going to do it.

The closing in 1955 of the remaining plants of American Woolen Company eliminated the giant of the industry. By July, 1959, however, a significant trend toward concentration had taken place. Data compiled by the Horton Mills personnel director showed the distribution of 96 percent of the employees among firms in the woolen-worsted industry as follows:

The Big Four	20,251 employees or	31.2 percent
The Little Four	5,825 employees or	8.9 percent
Independent (Nonunion)	18,806 employees or	29.0 percent
Independent (Union)	17,460 employees or	26.9 percent

The largest firm was Burlington Mills with 8,300 employees in 11 plants, only one being of unusual size, with 2,000 employed. The J. P. Stevens firm was next with 5,641 workers in 12 mills, none employing over 800 people. Chatham Mills had 3,200 employees in eight mills, the largest being 2,250 in size. The last of the Big Four was Deering-Milliken with 3,110 employees in eight mills, none exceeding 800 workers in size.[3]

Except for Amerotron, smallest of the Little Four, with only one mill (having 900 workers), no mill was reported as employing over 800 workers—other than the two listed for the Big Four. All of the mills shown with more than 800 employees were located in the southeastern states. None of the independent firms was found to operate more than two or three mills; most had only one mill. (The Horton mill with 525 employees was exceeded in size by only a few plants. It was described as the largest integrated woolen mill in the North.)

Horton Woolen Mills as an Institution

In July, 1960, William Slagle had served as president of Horton Woolen Mills, Inc., for more than a quarter-century. The woolen industry in the town of Horton dated back as far as 1865, and members of the Slagle family had participated for many years in its development. The plant of Horton Woolen Mills, commonly known as the Slagle mill, had undergone extensive expansion beginning in 1947. The old building occupying about 140,000 square feet was expanded during the next two years to about 300,000 square feet. New finishing, dyeing, and storage facilities to improve efficiency and make possible a more diversified output accounted for most of the increase. All of the finishing operations were consolidated at the Slagle plant to take care of materials produced at that mill and the Weldon and Wiley mills as well, which were owned by the same firm and located in towns nearby. The total cost of this program approximated $3,000,000.

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[3] The basic research data were not completely clear as to what extent capacity might differ from employment figures furnished, if at all.

Unfortunately a severe decline in the market for woolens in 1948–49, after most of the expansion was completed, created working capital problems which threatened the firm. New equity capital was required in order to secure a loan. The Wiley property was liquidated in 1948, and the Weldon mill early in 1949; but some of the machinery in the Weldon mill was moved to Horton. Complete repayment of the loan was accomplished early in 1955.

The shrinkage of capacity to one mill seriously affected the nice balance in production anticipated from the expansion. The 1947 three-mill capacity of 4,200 to 4,500 spinning units (100,000 yards of yarn being a unit) per 15-shift week was cut in half by 1949. Dye house and finishing capacity could then be only half utilized. During the next five years the installation of some Weldon machinery and the installation of new machinery raised capacity to about 3,000 spinning units.

The Slagle mill and one other woolen mill operated in Horton in 1960. The second was capable of employing about 350 people, but it was generally recognized that this mill had not worked nearly as many shifts in recent years as had the Slagle mill. The latter firm employed about 525 people; and the two mills together provided the principal means of livelihood for the more than 2,500 citizens of Horton. During the 1950's as some of the younger people gradually moved away, a greater percentage of new employees in Horton Mills came from neighboring communities where other mills had ceased to operate.

The Textile Workers Union of American-C.I.O. organized the mills of the Hart-Slagle interests early in 1940. The TWUA relationship continued into 1960. Earlier a workers' union of the 1930's collapsed in 1936 after a strike over the closed-shop issue.

Most problems of the firm received some consideration from the operations committee of Horton Woolen Mills, which in July, 1960, was composed of:

William Slagle, president and treasurer
Albert Willis, vice-president (dyeing, finishing, and experimental work)
John Warner, vice-president (other manufacturing, raw-stock buying, and labor relations)
Edward Willis, controller and assistant treasurer
Hugh Townsend, superintendent of the mill
James Watson, industrial engineer
Thomas Gordon, designer

This committee held regular weekly meetings to discuss problems in the firm and to review the operating results of the previous week. The first three individuals listed composed the top-management group, but all of the first five functioned at the policy-making level. All had held responsible positions in the firm for many years prior to the coming of James Watson in 1954.

In July, 1960, the sales office of the firm, located in New York City for ease in contacting the buyers of woolens, was managed by Ben Hudson. This separate corporation was a wholly owned subsidiary of Horton Mills. Coordination between the sales and production groups was generally excellent. Mr. Slagle maintained close contact with the sales group through at least one trip to New York weekly. Unlike many independent textile firms, Horton Mills had not relied on independent sales agencies working on a commission since 1932.

The Business of Producing Woolens

For six years James Watson had shared with line management the responsibility for continuing the improvement of operating methods begun by the consulting firm in 1949. During this time he became conscious of numerous inefficiencies, but he saw many difficulties cleared up by either capital improvements or changes in the method of operation.

During his last week on the job, Watson composed a lengthy report to Mr. Slagle analyzing the state of production methods in the different departments (with respect to his own responsibility) and presenting suggestions for further action. Even after six years he saw much to be done; change was slow and difficult. But he was impressed by the minor nature of most of the improvements which could be anticipated, given the limitations of equipment and first-line supervision. Only in the carding department was he distinctly dissatisfied with the progress to date in increasing efficiency, and difficulties seemed to be related to supervision.

In a few cases Watson suggested new or improved equipment. He proposed several changes for the next TWUA contract, and he emphasized the need for training supervisors in the techniques of management.

In July, 1960, a simplified explanation of the operation of Horton Woolen Mills was prepared as follows:

Procedures. Horton Mills buys wool already scoured and baled. (Scouring is the process of cleaning the wool by mechanical and chemical means.) Other materials used in some fabrics, depending on specifications, are synthetics and sweater clips picked apart by machine.

In *Stock Dyeing*, materials in storage are moved to the dye house, dumped into large, metal vats, and colored to specifications. They are then oven-dryed and held for immediate processing or, if the particular specifications apply to many types of fabrics, baled for storage and processing as needed.

In *Mix-Picking*, materials are prepared for the carding operation. All materials in a lot are mixed, made as consistent as possible throughout, and lubricated for carding. If several materials are to be blended in the yarn, different materials are weighed in the proper proportions and thoroughly mixed in this operation.

In *Carding,* the fibers of the raw materials are combed and opened out to lie separated loosely in a uniform thin film. Three of these carding actions are applied in succession in order to eliminate gradually impurities and short fibers. After the third carding action, a slight twist is applied to emerging fibers to produce a series of loose round strands averaging about ⅛ inch in diameter but varying with the yarn specifications. This *roving* is wound on a spool to complete the carding operation. (The carding operation is more lengthy in the production of worsteds than in woolens. This is a major difference between the two; but worsteds require materials having longer fibers.)

In *Spinning,* the roving is drawn and twisted tightly by machine to provide the strong threads needed in weaving and to place them on bobbins.

In *Winding,* the filling (yarn to be woven *across* the fabric) is rewound from the spinning bobbins onto smaller bobbins which will fit the magazines of the looms.

In *Spooling,* the warp (yarn to run lengthwise in the fabric) is rewound from spinning bobbins onto a large spool for holding until needed for dressing and weaving and for convenience in the dressing operation.

In *Dressing,* warp yarn is moved from its spool onto the warp beam (another large spool) for later transfer to the loom. If not all threads in the warp of a fabric are to be alike, two or more spools (having different yarns) are transferred to the warp beam (at the same time) in a predetermined sequence to fit the specifications of the fabric.

In *Weaving,* the fabric is manufactured on looms—essentially by interlacing two sets of threads, one running lengthwise (warp) and the other running across the fabric (filling). In preparing the loom for production, bobbins containing the filling are arranged in the magazine so that different yarns will be carried across the cloth by the shuttle in the proper sequence. Ends of threads on the warp beam are inserted into the loom harness before the warp beam is carried to the loom. This complex, time-consuming operation of drawing-in the warp is largely avoided in about 40 percent of the weaving jobs—when the yarn ends on the new warp beam can be tied by machine to the cut ends of the last fabric woven (left in the harness for that purpose). This machine tieing is possible only when the new fabric to be run on the loom will have exactly the same number of ends (warp threads) as that run on the loom immediately before.

The loom weaves cloth automatically once the warp beam and the filling bobbins are properly set up. In a perfectly plain fabric each filling thread (or pick) is run alternately over and under the individual warp threads; but variety in pattern and weave is secured from the way the warp has been dressed and drawn in and by the way the bobbins (with different yarns) have been arranged in the magazine. Cloth is woven in "pieces," averaging about 70 yards in length; each piece has a reasonable weight and bulk for wrapping and shipping.

In *Grey Finish* (or *Burling*), the woven cloth is run between a light and the inspector, who examines it and at the same time removes loose threads and makes other slight corrections. Where feasible, some imperfections are removed through *mending*. Also, "pieces" of cloth are batched or sewed together, six pieces to a set, for conveying downstairs for finishing.

In *Finishing*, the specific operations vary with the type of cloth being made. Customary operations are:

1. *Carbonizing*, where cloth is immersed in an acid bath, heated to burn any remaining foreign materials, and then run through a crusher to beat up the cloth to remove the carbon.
2. *Fulling*, where the fabric is shrunk in soap and water and then felted to force the cloth together into a sheet of interlaced wool fibers for superior insulation and to eliminate the homespun appearance of individual threads.
3. *Scouring*, or washing with soap and water.
4. *Napping*, where some of the wool fibers are pulled to the surface to conceal further the weave and produce a finish.
5. *Shearing*, where the napped surface is made smoother by cutting back the ends of the fibers drawn out by napping.

Some other operations in the Finishing Department are:

1. *Piece-dyeing*, where single-color fabrics are colored to specifications, the individual yarns not having been produced in such cases from stock-dyed materials.
2. *Decating*, to harden and set the fibers and add a gloss.
3. *Turbo-machine processing*, to produce an added sheen.
4. *Chinchilla-machine processing*, to give the fabric a certain characteristic, called pilling, on its surface.

The final operation is *perching* or making the final inspection, which includes top-level decisions as to the fabric's compliance with specifications and as to allowances to be made to the buyer (in terms of free yards) for various imperfections. Pieces of cloth are then rolled and wrapped and held or prepared for immediate shipment per instructions of the sales office.

As a rule, cloth is sold prior to its manufacture. Each style or pattern which is planned in advance of the season is given a number for identification. Each style or pattern is placed in a *range* of similar fabrics which can be priced to buyers at the same price. Styles differ within a range, but similarity exists to the extent that the range is considered as a unit in accounting for costs. However, an estimated cost sheet is made up for each style or pattern, and the quoted prices are related somewhat to the average estimated cost of patterns in the whole range.

The sales personnel show the line of samples to buyers and consummate contracts for delivery. Small orders for a certain item may be accumulated until a manufacturing lot of reasonable size can be sent to the mill. Many inefficiencies in manufacturing develop from producing small lots of cloth.

Manufacturing for the fall season is begun ordinarily during the first week in November of the previous year—planning the line and some selling having taken place by early autumn. Deliveries often start in December and may continue even into October; but most are made between early February and August. The women's-wear season is frequently shorter than this. With the existing emphasis on style goods, there is little production for stock; forced selling of fabrics takes place only at a drastic reduction.

Except during the 1940's to 1948, Horton Woolen Mills has disposed of receivables through factors, a traditional procedure in textiles. The factoring organizations are specialists in credit with respect to the buyers of textiles. Buyers who are willing to purchase early in the season are able traditionally to secure quite long credit terms; therefore, the amount of capital tied up in receivables for the output of a single mill may reach staggering proportions.

Pressures for Change

Several of the ranking executives of Horton Woolen Mills were associated with the enterprise prior to 1929. James Watson could depend on any of them in July, 1960, to testify concerning the magnitude of the contrast between "then" and "now" with respect to operations and the overall management process.

Then "overhead" was much less important. A few relatively simple heavy fabrics were produced in great volume; often the season's capacity was sold by the time production started. Profit margins were substantial. Three shifts were rarely worked. Payrolls and bookkeeping were simple —no complicated incentive-pay computations, no taxes on payrolls, no overtime or shift premiums, no multitude of deductions, no complicated reports, and no union contract to which to conform. Employees were paid typically either a weekly salary or on the basis of simple piece rates. The overhead costs in the main were devoted to the direction and oversight of production.

In 1960, Mr. Slagle's father was quoted as having explained during the 1920's that the workmen making the most money for him were those standing with nothing to do—a signal that all was well with operations. He was credited, also, with the ability to recognize the signs of any sort of problem in production simply by walking through the mill. Clearly, the driving pressure for large output per worker was not present then.

The great depression decreased effective demand and forced a cutback in production, and the resulting pressure on selling prices put a squeeze on margins. By 1933, three-shift operations became more common. Much of what happened during the 1930's was beyond the control of management. Employees worked when orders were available. At other times only a few *had* to be paid, though many mill owners undoubtedly tried hard to secure orders, even at prices barely covering variable costs, to keep employees on the payroll as much as possible.

There was some improvement but not much basic change, except for payroll complications, prior to 1940. Military and lend-lease production began about that time. The TWUA union entered the picture. Multishift operations began in earnest. But still the product was simple and standardized. Profit margins were generally adequate, but future price renegotiation on government contracts made the ultimate profit rather indeterminate at the time. The principal management effort was still concentrated on straight production.

By 1947 it became clear to Mr. Slagle that major adjustments would be necessary in the near future. He set out to integrate the operations of the three remaining mills and improve their efficiency. (This was in fact the carrying out of plans conceived by 1941.) At that time he saw the probability that the firm would want to expand its line to secure new markets.

Mr. Slagle could hardly have appreciated then the significance of the reduction in United States tariffs negotiated for woolens in 1947, nor could he have foreseen the great upward pressure put on textile wages by the postwar inflation or the impact on his business of the 1948–49 recession. He would have had to be a prophet to see the imminence of the financial difficulties of his firm in 1948 and the continuous all-out effort of the 1950's (except for the brief return to military production starting in 1950) to keep out of the way (as he expressed it) of the steamroller of imported fabrics. The extent to which consumer demand would move in the 1950's toward the new lightweight fabrics could scarcely have been foreseen, though signs were on the horizon by 1946. The expansion and modernization program of the firm, started in 1947 (together with the shift in product mix it made possible), received credit in 1960 for the ability of the firm to roll with the economic punches of the preceding 12 years. However, modernization was not enough; each new maneuver created new problems of adjustment.

In this experience a new type of management team evolved. The operations committee always seemed to be facing some complicated adjustment, either imminent or long-run. The specialist's "instinct" for finding new ways to save pennies became important to success. A determined effort became necessary to secure 15-shift operation (per week) most of the year—as an offset to decreasing profit margins per yard.

Installation of the Incentive Premium Pay Plan

After the battle for survival in 1948–49, the professional management consultants moved into the Horton Mills plant to seek ways to improve efficiency and reduce product costs. Though the intensity of effort varied, their services were continued for about five years. They set out to install an incentive pay plan through most of the production steps, extending the drive for worker motivation found in the piece-rate system traditional in woolen mills in the spinning and weaving operations. No precedent existed in the woolen industry for such an undertaking. It was recognized that worker and union cooperation would be of great importance.

Careful analysis of the jobs frequently revealed the need for both equipment modernization and the conversion of manual to mechanized operations through new equipment. In general, only efficient operations were standardized for incentive wages.

The incentive plan was designed to eliminate hourly wage payments to the fullest extent practicable and substitute wages based on efficiency. Standards for a "fair day's work" were set for the jobs covered by the plan. The general plan as distributed to workers in November, 1951, contained (among many others) these explanations:

> Incentives are always paid over and above base pay. . . . An employee makes at least the base hourly rate. . . . Premium is paid full value for production over standard, one percent additional premium for each one percent increase in production. . . . Every reasonable effort is made to set standards to provide employees a fair incentive opportunity during their full working day. . . . Time is allowed in the standards for fatigue and personal needs. . . . The amount of time added varies for different kinds of work and is higher on the more tiring jobs. . . . Premium earnings except where impractical are figured on the net results of one day's work. . . . A daily record is made in the shop on check sheets of the type and amount of work done by each employee together with all extra work and delays that are beyond his control. In order to receive fair credits the employees must assist in getting these records correct. Delays are credited at actual time lost because they cannot be allowed for in the standard, with fairness to the individual.

The consultants had as their objective the setting of standard production on jobs at 50 percent higher on the average than that previously accomplished during a day through hourly wages. It was generally admitted that this objective was approximately achieved. Improvements in methods and technical support supplemented the pressure provided by the worker's increased motivation from having his wages depend on output.

Progress was rather slow. The napper operation in the finishing department was placed under incentives in July, 1949. Within about seven months three more operations were added. In January, 1951, the new plan covered only 39 employees. Testimony in the first union-management arbitration over incentives (held late in 1951) indicated that by then only 23 jobs were covered. The Korean conflict undoubtedly slowed the progress of the plan. Extension was delayed at one point, in 1951, while the company secured assurance for some opposing workers that wage increases accomplished through incentives were *not* forbidden by directives of the National Wage Stabilization Board.

Reference to the development of incentive plans was first included in the union contract effective in February, 1950. In this contract the need was recognized for "improved methods of manufacturing" to be "approached in a fair and open-minded way" by management and labor for their mutual benefit. Express provision was made that the company might institute new pay methods and "have the right during this agreement to install incentive premium plans." The understanding was expressed, on the other hand, that the union had not agreed to an incentive plan or to standards and had reserved the right to oppose any such plan or standard. It was provided that if the company proposed an installation or change not acceptable to the union, the parties might agree to a trial period during which the earning rate previously effective would not be reduced. If the use of a trial period could not be agreed upon, the question of a trial period and its duration might be submitted to arbitration.

Similar clauses appeared in contracts through that applying to the two-year period beginning November 15, 1958. These contract provisions were generally credited over the next few years with giving the company considerable power in determining and redefining what constituted a fair day's work. Joe Smith, an employee who was a union leader in the early 1950's, stated in 1960 that this contract clause concerning incentives had been the union's major argument in convincing obstinate workers that they should cooperate in a trial period for incentives. In his opinion, it tended to put the burden of proof on the union in an arbitration concerning the unreasonableness of a new work assignment.

Numerous grievances arose as additional workers saw their own assigned workloads increase—with only a *hope* for increased earnings from even greater improvements in production. The response varied with the workers involved and the nature and extent of the changes.

Considerable opposition arose in the dye house (one of the first departments affected), where the standard output was doubled with considerable aid from improved technology. Several older workers found the new assignment too demanding physically and moved to jobs in other departments. Younger men from other departments replaced them and soon were earning premium pay. One of these men recalled in 1960 that for a time he had been somewhat ostracized by many other workers for having a part in proving the new plan workable.

In the carding department, where the job organization was changed considerably (skilled workers taking over some jobs requiring little skill) and where two men did the work previously expected of three, there was vigorous opposition. An unauthorized walkout developed. The supervisor of the department left the company during the difficulties. (He was characterized by superiors as being intelligent and quite competent technically and as getting along well with people, but as being inclined to fraternize with his employees excessively.) The right of the company to a trial period under the new plan in the carding department had to be established by arbitration late in 1951.

Ed Dixon, a weaver, recalled in July, 1960, that the general attitude in the mill had been opposition based on misunderstanding and fear of the unknown. Many workers with little seniority were certain they would lose their jobs as two employees took over the work of three. He stated that apparently resisting workers were little moved by the repeated statements of vice-president John Warner that the company *had* to have the new plan in order to be competitive. The wave of mill liquidations had not yet become impressive generally.

After 1953, as more and more jobs were placed under incentives, opposition became less vigorous, especially as those under the plan found that greater effort did in fact produce a wage increase of about 15 to 25 percent.

Doubtless opposition was tempered by the fact that employment conditions were such that workers eliminated at the installation of the plan could be absorbed elsewhere. In 1953 a spokesman for the consulting firm explained that though 120 jobs had been eliminated, increased production in the plant had held personnel displacement to negligible proportions. He was quoted as saying also that workers were satisfied with the new standards and would be unwilling to give them up. (At the same time, he explained that the incentive plan had been accompanied by about 30 major reforms in the manufacturing operations and that the consultants had recommended capital outlays on the machinery, in most cases, which were expected to have pay-out times of a year or less.)

In the arbitration hearing in August, 1959, a national TWUA officer, boasting of union cooperation with Horton Mills over the years, virtually claimed union sponsorship of the incentive plan, citing the 1950 contract provision as "recommending an incentive plan" contemplated by the company. He lauded the mill as having in 1959 the highest output per employee in New England, taking into consideration "the type of machinery they work on." He obviously desired to give the incentive-pay plan much of the credit for the mill's remaining competitive in the 1950's. Regarding early difficulties with workers, he referred to "our terrific problem" in selling "to our membership such a plan" and explained the union officers' attitude as: "We felt we had to face it and we [were convinced along with management] that greater efficiency would result in greater earnings for the workers and we were willing to give it a good try." However, he characterized the introduction of the plan as three years of real torture for the union, workers, and company.

Employees Smith and Dixon agreed that the new plan had been introduced with great care by the company. In every case, they said, the new job assignment had proved itself during the trials. Adjustments were made (based in part on worker suggestions) until the work expected could be done with consistent but reasonable effort.

The Control of Labor Cost

The accounting program of Horton Mills in July, 1960, did not include a formal system for cost accounting. Costs were entered as incurred by charging them directly to departments by object (ordinary expense accounts). Inventories taken at the end of each accounting period were based on a quantity count and priced or extended on the basis of the estimated cumulative cost to the inventory date as obtained statistically—roughly by dividing departmental costs for the period by the output of each department. Hence the breakdown of costs by departments and the record of units produced provided approximately the information expected of a product-cost system—but with less attention to complete accuracy as to detail. The accountants kept the records in no greater detail than management demanded for their own knowledge concerning what was happening. The controller was convinced, however, that because Mr. Slagle was concerned over costs and cost trends, the firm kept more detailed records and devoted more time to cost analysis than did most firms in the industry.

The accountants maintained perpetual inventories—outside the formal records—for Raw Stock, Dyed Stock, Warp, Goods in Process (Finishing Department), and Finished Goods. For yarns in process (that is, prior to the warp stage), monthly inventory figures depended on physical inspection and estimated unit costs.

At later stages, the perpetual inventories and cost calculations were based on fabric *ranges.* First, during the planning stages the controller and the vice-president in charge of finishing estimated the cost of planned items on an estimate sheet, listing all possible material, labor, and overhead costs in detail. Later an estimate sheet for each range was worked out, based generally on a simple average of the estimated costs of all styles or patterns. At the end of each month, the output of each range during a month with respect to each department (weaving, grey finish, and finishing) was multiplied by the planned cost per unit (from range estimate sheets) for materials, labor, and overhead. If actual costs during the month exceeded this estimated cost for any of the three categories, an unfavorable variance in the amount of the excess was recognized for that category in monthly reports. The opposite relationship produced a favorable variance.

In pricing inventories for monthly income statements, *estimated* costs for product on hand were usually accepted, but year-end inventories were stated roughly at *actual* cost by allocating to inventory a proper portion of the year's variances between estimated and actual costs for the units produced in terms of ranges. Overhead costs ordinarily were not adjusted in this way to actual from estimated amounts, because 15-shift operations were considered *normal* for purposes of pricing inventory, though an unfavorable variance usually could be expected in overhead, from operations averaging less than 15 shifts a week.

None of this analysis affected the formal bookkeeping—except for determining the pricing of quantities for year-end inventory adjustments. Neither perpetual inventory figures nor inventories taken by actual count for monthly statements of income were recorded in the accounts. A quarterly physical count was used to check the informal figures for perpetual inventories.

With the completion of the incentive premium pay plan, the *mechanics* of labor cost control on about 72 percent of the production jobs became simple, that being the proportion of production workers on either piece rates or the new plan. Here the amount paid for productive time could be associated directly with the units of output. Amounts paid for a certain task in excess of the amount allowed by the latest standard for the output recorded were recognizable at once as an unfavorable variance or fall-down.

Prior to the installation of the incentive-pay system, management attempted to judge inefficiency on the basis of rough department-wide "standards"; but not much cost control could be exercised in practice, in the judgment of Watson, because it was so difficult to fix responsibility or explain fall-downs over so wide a range that little attempt was made to do so.

In his last report to Mr. Slagle, Watson mentioned the difficulty experienced in getting cost-control information in some operations in the storage department where standards did not affect wages—workers receiving hourly wages.

Each week after the calculation of the payroll, other personnel in the controller's department received the information as to amounts paid for each task (commonly called *operation*) during the week and the amount of output as well. These people calculated what the labor cost should have been for the output in each operation on the basis of standards. The differences between amounts paid and this standard cost for each operation were then reported to management each week on a form called "labor variance & analysis"—both the dollar amount of variation and the percentage of variation. This report presented the variances on 57 different tasks, including supervision. It was complicated by the fact that those preparing the report actually had to compute the standard cost throughout on two bases: first, the engineering standard, emphasizing what the cost ought to be; second, the accounting or cost-sheet standard, emphasizing planned cost at the beginning of the year (with later adjustments in some cases), this being the costs per unit reasonably to be expected. In general, the engineering standards were more demanding than the other group, of course.

The report for the weaving department for the week ending June 25, 1960, appeared as follows:

Weaving Department Variance Report June 25, 1960

Variance, Cost Sheet Standard			*Variance, Engineering Department Standard*	
Dollars	*Percentage*		*Dollars*	*Percentage*
95*	22*	Supervisor—Overseer and second	161*	44*
35*	3*	Labor—Fixers	89*	11.3*
6	1	Warp service	113*	17.5*
207	60	Yarn carrier and bobbin strip	165	52
173*	4*	Weavers	302*	9.7*
		40 hour basis		
141	100	Overtime	62	100
51	0.9	Total $5,902.18	438*	8*

* Negative amount.

The production for the week was measured in the weaving department and reported to payroll as 41,577 picks, as compared with the engineering standard of 71,000. The analyst in the engineering department who worked with weaving went over the week's report with the overseer. He determined that the low operating level was primarily responsible for the unfavorable report with respect to the first two items, supervision and fixers. The ratio of picks to loom-hours was above standard, suggesting good performance, but the ratio of loom-hours to manhours in both cases was below standard. They found that in warp service fewer warps were started than standard for 41,577 picks (indicating larger warps and less setup time than standard), that the percentage of warps tied-in by machine was well above standard (indicating larger lots or a more favorable run than average of similar fabrics), and that the unfavorable variance of $113 was accounted for by the need for warp-service personnel to fill in for yarn carriers in the bobbin-stripping task, because some of the people in the latter group had been laid off. He found that at least $144 of the favorable variance shown for yarn carriers was based on the same situation.

With respect to weavers his analysis showed 80.4 percent theoretical efficiency as compared with standard of 75.2 percent. Yet, overall, he found that the cost per weaver hour had been $2.303 instead of the standard $2.24 and that the ratio of loom-hours to weaver-hours had been only 5.03 as compared with the standard 5.78. He felt that these unfavorable indications (despite the previously cited high theoretical efficiency) arose primarily from the unusually large amount of pick-and-pick weaving during the week, the proportion being 8.4 percent of the picks instead of the 1.8 percent allowed in the standards for the weaving department. (For certain fabrics the pick-and-pick looms had to be used instead of the regular looms, and a weaver was required for two of these looms, as compared with the customary six-loom assignment.)

The engineering standards allowed for overtime premium in the amount of $62 for the week. The favorable variance at that point was produced by the fact that no overtime was worked during the week.

Similar analyses were made for most departments, depending in part on information received directly from the operating departments.

Watson knew that incentive plans worked best where operations were completely standardized, where the tasks varied little if at all, and where quality could be objectively ascertained, as with a micrometer, so that poor work could be identified and penalties assigned to those responsible. He felt, however, that the plan had proven its value at Horton Mills despite the general lack of this standardization. He believed it had made overseers more conscious of substandard performance. He explained that standards by their nature had to be based on averages but that wide variations, which could be expected not to be typical but to occur at times, had to be excluded in the setting of standards.

In practice the occurrence of these events not allowed for in the standards forced the return of the worker to his regular wage—in the case of the piece-rate worker, to his average earnings. Examples cited were machine breakdown, other machine downtime, power failures, running out of work, and doing special work such as the preparation of sample fabrics. In addition, the standards (being only averages) often included departures from the type of situation which suited or fitted the standard exactly. These caused variations in the pay per hour of the incentive-wage worker or produced variances in the weekly report, depending on how such a departure was permitted to affect the wage calculation. Examples of such variations were inferior material (causing slow work, interruptions, or reworking), special weaves, wage-rate changes caused by the shifting of personnel from regular jobs, and the running of smaller jobs or lots than contemplated in the standards. Unstandardized conditions of both types complicated the standards application at Horton Mills.

The results of the engineering analysis of each week's variances were considered at the next meeting of the operations committee. Watson felt that too much time was devoted to seeking explanation and justification rather than to searching for means of improvement. He believed that the unswerving support of Mr. Slagle had been necessary to his accomplishing as much as he had.

Impact of the Firm's Policies

During his last weeks at Horton Mills, James Watson occasionally stopped to wonder what the future might hold both for him and for the company. He speculated as to the comparative position of the firm and its owners in 1960 had other estimates of the future been made in the postwar period by the management. Could he himself have contributed to more rapid improvement in efficiency? Sometimes progress had seemed very slow. Did improved worker motivation under incentives "save" the firm? Or could management have improved output per worker, as had been suggested more than once, if they had tried with determination, without the cost and inconvenience of the complicated incentive-pay plan?

Could the firm's capital have been used more effectively elsewhere after 1948—or, better, after 1946? Then what would have happened to the town of Horton? Watson had heard persistent rumors that two mills not far away probably would close in 1960. He reflected that in closely held corporations (such as most independent woolen mills) the stockholders' goals cannot be thoroughly separated from their total motivation as individuals.

In 1960 the influence of management policies (as a positive force) on the welfare of the workers, the owners, and the community could be seen more clearly than in 1946. Textile mills clearly demanded aggressive leadership during the period after World War II if they were to succeed. But by 1960 the evaluation by economic forces of particular long-run decisions had not yet been completed for Horton Mills. Would it survive the decade of the 1960's? With each strike, Mr. Slagle received letters from many states, urging him to move his plant.

The Production Workers. According to a company exhibit used in the 1959 arbitration case, Horton Mills workers received wages averaging $1.90 an hour for work in May, 1958:

CHANGES IN COST OF LIVING AND AVERAGE GROSS HOURLY EARNINGS IN WOOLEN AND WORSTED INDUSTRY AND HORTON MILLS

Period	*C.P.I. 1948–49 = 100*	*Industry*	*Horton Mills, Including Overtime and Shift Premiums*	*Percentage of Increase over June, 1950*		
				C.P.I.	*Industry*	*Horton*
June, 1950	101.8	$1.324	$1.440	–0–	–0–	–0–
June, 1951	110.8	1.465	1.649	8.84	10.65	14.51
June, 1953	114.5	1.57	1.796	12.48	18.58	24.72
June, 1955	114.4	1.52	1.754	12.38	14.80	21.80
June, 1957	120.2	1.60	1.803	18.07	20.85	25.20
May, 1959	124	1.68	1.900	21.81	26.89	31.94

Increases since 1950 at Horton Mills were compared with those of United States wages in the industry and with the rise in cost of living —all to the advantage of Horton Woolen Mills' employees.

Wages paid regionally per hour (not including overtime or shift premium) for woolen-worsted production workers in 1959 were presented comparatively:

United States	$1.56
The South	1.39
New England	1.595

The wages at Horton Woolen Mills were shown on the same basis as $1.76. A union witness charged that the Horton differential in both cases was accounted for in large measure by harder work under incentives. (The company explained that many other firms operated incentive plans also and that extra fringe benefits more than made up for that difference anyway.) Regardless of cause, it was admitted that the production workers at Horton Mills were among the highest paid in the woolen and worsted industry. The arbitrator in the case added 8.5 cents an hour to the above figures for Horton Mills late in 1959—under a wage-reopening clause in the two-year contract. This amount was his interpretation of the general increase in wages in the industry since the contract was signed.

The working environment at the mill, while not perfect, was well above average for woolen mills, and conditions had been improved greatly in many respects since 1946. The cost of living in the town of Horton and in the surrounding towns from which workers were drawn was relatively low for New England, according to the personnel director of Horton Mills. Frequently two or more members of the same household were employed at the mill.

Based on his experience in other mills, James Watson believed the morale of workers to be average or better at Horton Mills. He considered some complaining and criticizing normal. Many workers, having already lost jobs and seniority in a liquidated mill, were forced to travel many miles to work daily. Some skilled workers complained that young men of their acquaintance with little experience could secure jobs in other industries for as much as *they* were able to earn after years of experience—in a declining industry. About two thirds of the workers were union members in 1960.

A fair number of workers undoubtedly felt that the pressure to turn out volume was excessive because of the incentive system. Though Watson often heard references to "unreasonable demands" and similar "griping," he thought most employees were satisfied with their jobs. Some workers felt considerable pride in their rate of output; one remarked with respect to another woolen mill with which he was well acquainted: "They won't be able to stay in business. Why, we do more *mistakes* in a day here than they do *work* there."

Two men who were closely involved in the initiation of the incentive system, through leadership in the union, agreed in July, 1960, that workers generally were adjusted to the plan and that a clear majority (and perhaps three fourths) of those involved would resist strongly any attempt by the company to return their jobs to an hourly pay basis with workloads comparable to the old. They expressed the belief that workers performing conscientiously under the old plan did not have to work much harder to secure incentive pay under the new plan.

The Community. As compared with many woolen-mill towns, Horton had many advantages in 1960. Neither of its two mills had been liquidated. Workers were employed at the mill—to the extent they desired—

and others were being recruited from nearby towns, despite a provision in the contract with the union giving priority in hiring to local residents.

During the 1959 arbitration, Mr. Slagle described employment as relatively dependable, the mill being "one of the steadiest operating woolen mills in the United States; . . . certainly as steady as any in New England." At the same time he described the community as having "one of the highest standards of living" of any industrial town in the New England area. In July, 1960, while most of the town was not at all pretentious, the low-income type of housing and surroundings was clearly not in evidence. Horton scarcely resembled a mill town.

The Company. Horton Woolen Mills survived the plague of liquidations in the New England woolen industry through July, 1960, at least. Regardless of the cause, that fact seemed worthy of note when the number of workers in the industry in New England had declined by about 70 percent within 13 years.

According to Mr. Slagle, his mill was kept in business by *volume*, in view of the very low profit per sales dollar. He stated that the industry's profit was averaging about 2 percent of sales.

The postwar adjustment of Horton Mills was based on three major steps, which were closely interrelated: modernization and expansion, the use of standards for wages and labor-cost control, and the expanded product line.

Without the first of these, the other two could hardly have occurred. Outlays in this program were estimated by an official in 1960 to have aggregated between $5,000,000 and $6,000,000. In July of that year the second of two new shearing machines was being installed; it was informally called "the $20,000 job." (Very little new basic textile machinery was purchased in New England in the postwar period. Used equipment in good condition was available at attractive prices.) Mr. Slagle stated at the arbitration in 1959 that the firm had followed all recommendations to keep "a woolen mill alive in New England."

It was recognized in 1960 that the incentive premium pay plan had brought extra clerical work and other disadvantages. The controller estimated that at least four people in his department were made necessary by the incentive-pay plan and labor-cost control. Clearly, the calculation of payroll was quite complicated, and unusual care was necessary to avoid errors. The engineering department used the equivalent of about one man on this analysis and standards work. In past years the load had been at least one man greater. The plan also required considerable attention on the part of overseers and the workers themselves. In general, each worker had to itemize the time when he was *not* doing any operation in which pay was based on output—as in machine downtime—by recording the exact beginning and end of the period. Since his wage during this period would be his regular wage, the temptation was present always, of course, to state the end of the regular-pay period later than it actually was. The personnel director stated that in some departments there was currently almost no place for recruits to begin work, since nearly all jobs under the new arrangement demanded skills. The problem was particularly important in carding.

The incentive-pay plan undoubtedly had helped to create a higher-paid, more productive labor force at Horton Mills. Management generally believed it had served to reduce unit production costs, both by providing more knowledge about costs and by increasing the production received for each dollar of wages.

When their traditional markets began definitely to shrink about 1953, Horton Mills started to offer a broader line in an effort to secure volume production. They moved with considerable success (from the sales standpoint) into tweeds, sport-coating, and camel-hair fabrics during the next few years. The head of the sales organization stated in 1959 that in order to get business "we must bring out what amounts to, in a mill of our size, a tremendous line." He characterized this as an uneconomical and difficult way to run a mill of its size—trying to do all "that the giants do." He expressed a belief that everything possible in this direction had been done: "We wouldn't know where to turn next."

The following selected figures were provided by management in 1960 to show quantitatively the effect of this policy on output:

	1949	*1951*	*1952*	*1958*	*1959*
Number of ranges	46	31	35	140	144
Number of styles	242	245	725	1,218	1,452
Number of yarns	108	107	127	310	455

None of these quantities reflected fully the difficulty of the change, but together they suggested the increased problems of designing, planning, sample creation, and machine setup related to the greater diversity of output. The average lot size for each operation was reduced greatly. From the standpoint of production the more frequent change from one lot to another meant more setup and cleaning time all along the line; it brought greater difficulty with quality control; it increased the supervisory load and made scheduling more complex. Similarly, it decreased the significance of reported variations from standard performance. It made necessary the purchase of new and more specialized finishing equipment at intervals; it reduced the amount of work done by each finishing machine on the average.

Thus a rather successful solution to a marketing problem created a whole series of production problems. The difficulty seemed never-ending. The best profit margins were available on *confined* lines, those with great appeal and made for only one or a few clothing manufacturers; but this emphasis tended to expand the line still more, based on the creativity of sales personnel and designers. Profits on *open* lines, more standardized and available to all, were described as paper-thin, serving principally to keep the mill running.

As customary in closely held corporations, the owners of the firm, in the main, also worked for the corporation. Success for the firm meant success for them, of course; the continued functioning of the firm provided them with an opportunity to be "their own boss," at least to a limited extent, in a way generally considered attractive. The firm provided them with jobs which utilized their long experience and abilities to the fullest extent possible. The owners felt satisfaction, also, in the continued existence of the firm (despite difficult pressures) as an institution with a tradition and important to their community. The son-in-law of Mr. Slagle and, also, Mr. Warner's son, an engineer, had recently joined the firm.

As James Watson left this firm on July 16, 1960, he was quite certain as to one point: His last six years had been in many ways a challenging and interesting experience.

Petrola Oil Company[*]

Company Development

The operations of Petrola have encompassed four decades which can be identified as the Roaring 20's with flappers and speak-easies; the Depressed 30's with soup lines and the New Deal; the War-torn 40's with draft calls and rationing; and finally, the Fabulous 50's with shopping centers and satellites. Through these decades, the company has had bright years and gloomy years, but these years were years of growth. Its early development was similar to that of other oil companies, with initial interest centered primarily in the development of crude production and crude reserves plus the manufacturing of various petroleum products. Over the years, various acquisitions and mergers have taken place and some of the interests acquired go back to the early days of the petroleum industry in America.

The history of the development of Petrola would involve the history of the many companies which have been brought together over the years. Resources of this complex petroleum organization include domestic and foreign producing properties, over 4 million acres of undeveloped leases, several refineries, production of crude in excess of 25 million barrels a year, holdings of over 4,500 active producing oil and gas wells on over 2,000 leases, a distribution system for marketing products in 25 states and exports to practically all countries outside the Iron Curtain, and over 6,000 employees.

Petrola is a fully integrated oil company, performing all of the following functions: Discovery of oil through the efforts of the exploration department, using the latest geological and geophysical apparatuses and procedures. Producing crude petroleum which involves the operation of a land department to secure leases for property on which oil may be discovered, and the actual drilling of the oil well. Refining which transforms crude into a multiplicity of products by means of costly equipment and special chemical processes. Marketing which moves the products through the various channels of distribution to points of consumption, both domestic and foreign.

Present management of the company is set up with three principal levels. Beginning at the top there is the Home Office level, representing the main coordinating body, which formulates all major policies. The second level is the Division Office, which is primarily concerned with operations and the execution of company policies. The third is the District level, which is nearest the point of operations and the area in which the company exploration, production, and sales representatives operate.

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[*] Prepared by William H. Day, University of Tulsa.

Various changes in organization have taken place through the years to adapt to changing conditions and differences in company operations. In recent years, the development and utilization of committee organization has been rather widespread. Management believes that maximum results ensue from group thinking. This group dynamics is done without devoting a disproportionate amount of management's time to committee work. Various committees have been organized in addition to the board of directors. One such committee meets on a schedule to facilitate the work of the board of directors. Another committee meets weekly to consider all policy matters. Another committee has been set up to facilitate planning and coordination. This committee is composed primarily of operating and finance executives and meets only periodically to consider and evaluate current operating problems, make plans for future steps, and outline procedure for coordinating the many functions of the company.

Company Products

Products manufactured by the company include premium gasoline, housebrand or regular gasoline, lubricating motor oils, grease lubricants, jet fuels, kerosene, residual fuel oil, propane, numerous other (LPG)[1] products, alkylate, naphthas (including cleaning solvents, paint thinners, and so on), aviation oils, industrial oils (including special oils for equipment ranging from sewing machines to giant turbines), waxes, petrolatums, fracturing oils, outboard motor oil, diesel fuel, tractor fuel, petroleum asphalt, coke, carbon black base, tetramer, and other petrochemical intermediates. Some of these products such as gasoline and motor oil are marketed under the Petrola brand name whereas most of the other products are marketed unbranded. Methods of transportation include barge, pipeline, truck, tankcar, and oil tanker. On the basis of percentage of volume shipped, water transport accounts for 39 percent, trucks 36 percent, pipelines 19 percent, and railroads 6 percent.

Although some competitors have shifted to three or more grades of gasoline for the service station customer, Petrola prefers to concentrate on a high grade housebrand and a premium grade gasoline.

Pricing Methods

The pricing of petroleum products began as a seller-oriented phenomenon back in the days of John D. Rockefeller when his companies controlled approximately 90 percent of the pipelines and over 80 percent of the refining. Various price policies have been followed by major oil companies. Some of these are:

1. An oil company can be a leader and attempt to base prices on the cost of production.
2. It can be a leader in a small market and have low competitive pricing to keep competition out.
3. It can be a follower and follow its leading competitor in each area.

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[1] LPG refers to Liquefied Petroleum Gases such as butane and propane.

Petrola has adopted the general policy of following its leading competitor in each area of its market. There are exceptions in the cities in close proximity to its refineries where Petrola is the leading marketer and in such cases follows the first policy indicated above. Two bases are generally used in pricing petroleum products, namely f.o.b. refinery or delivered. Petrola normally uses both methods. Products are sold at different prices depending upon the classification of the account. Suggestive of the various classes of accounts are the following: railroads, other major companies, unbranded companies, branded distributors, consumer (transport sales), consumer (tank wagon sales), consumer (bid), service stations, and governments (federal, state, and local).

Railroad prices are established either by bid or by private negotiation. Prices to major companies, unbranded companies, and branded distributors are determined by private negotiation. Consumer (transport sales), consumer (tank wagon sales), and service station prices are set by the company. Consumer (bid) prices are set by the bid. Government prices are usually established on a bid basis, but are sometimes set by private negotiation. Occasionally, the company is faced with the disposal of "distress" merchandise of gasoline or lube oils which are sold at privately negotiated prices sometimes below cost. Excessive amounts of such products unloaded on a given market can trigger a price war, which leads to subnormal prices.

The expression reported in *Platt's Oilgram* (see Exhibit 1) is indicative of the attitude of a company toward a price war or chaotic competition. While management does keep abreast of price fluctuations as published in the *Platt's Oilgram* and also the *Wall Street Journal*, the general feeling as expressed by one executive is "all books on pricing in the oil industry are history. Books cannot keep up with the competitive situation in the oil industry."

Petrola is similar to other companies in the industry in that it has "exchange agreements"[2] with other refiners. These agreements usually provide some savings on transportation costs and became of greater general use at the encouragement of the government, in order to expedite products during World War II. Sometimes it is necessary to make several agreements to secure the amount of products desired in any given area. If exchanges cannot be made, it may necessitate purchase of products from other refiners in that area. Normally all exchanges and purchases are privately negotiated.

Retail Outlets

Petrola Oil Company for many years followed the conventional rectangular building similar to that used by almost every other company in

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[2] These agreements provide for an exchange of products between companies at different points which are generally more advantageous to each company. The exchange might be on an even basis or a differential may result necessitating some payment by one of the companies involved.

EXHIBIT 1

FROM PLATT'S OILGRAM OF MARCH 29, 1960

REPUBLIC SEEKS "SANITY" IN NORTH CAROLINA "GAS" MARKET WITH NEW POLICY

Pittsburgh 3/28—Republic Oil Refining today expressed grave concern over consequences to industry and the public of "present chaotic condition" in gasoline marketing in North Carolina, and announced adoption of new wholesale pricing policy with respect to that area.

While not detailing new policy, company said:

"The following message is admittedly strong talk, but as a petroleum marketing leader in North Carolina, Republic Oil Refining Company feels that a public statement concerning gasoline prices in North Carolina is long over-due. Our statement concerns the present chaotic condition that exists in petroleum marketing in North Carolina. The situation, as viewed by the ultimate consumer in North Carolina, is gasoline selling at bargain prices.

"The immediate purchase savings to the public appear to be sizeable. The long-range benefits to the public, however, appear to be the reverse of savings and economy. What could well happen is the elimination of a virile group of independent marketers and their independent refinery suppliers. Frankly, the situation is this, and we risk public, industry and our customers' opinions in stating it.

"Initially, the independent petroleum marketer was supplied by the independent refiner. The growth rate of the independent petroleum marketer became nothing short of fantastic. Then major refiners and marketers elected to also sell the independent marketer product. This appears to be carrying water, or gasoline on both shoulders.

"The result has been chaotic as the price structure has deteriorated to a point where there is little room left for the independent refiner and marketer. It is our conviction that neither the major suppliers nor the independent suppliers can justify the existing price of gasoline from a profit standpoint.

"While it may appear to be mere fantasy, it could happen that the very competitive independent marketer may one day have only one source of supply. This could happen if the independent refiner, of which Republic Oil Refining Company is one of several, elected to eliminate marketing where profit no longer exists. Republic Oil Refining Company views the continued trend as dangerous to the ultimate welfare of the consumer, the dealer and the industry. Republic hopes, through this action, to influence the thinking of others in the petroleum industry in restoring economic sanity to petroleum marketing in North Carolina. Republic feels that it owes this effort to petroleum marketers and to their immediate welfare. The public can only be properly served by healthy marketers who can continue to provide future benefits to the public only through a just and reasonable profit.

"In keeping with the established fact that no industry may survive without adequate profit, Republic Oil Refining Company is inaugurating a new wholesale pricing policy based on realistic economies with one single thought in mind—the sound economic future of the petroleum marketing in North Carolina and all southeastern states."

the oil industry. There was little variance between companies in service station design; however, in the 1950's a new design was inaugurated using a split-level roof with other innovations. There was also a departure from the conventional block construction to a prefab construction on a metal frame. Prefab stations are supplied by Chicago Vitrous Corporation, Chicago, Illinois; Avoncraft Corporation, New Orleans, Louisiana; and Strand Chambers, Oxford, Mississippi. The move away from the block is explained by the fact that the prefab cost is about the same as masonry and porcelain on three sides plus paint inside and out. The prefabs require no painting. There is the saving in the prefab of the cost of painting once every three years with an average of six paint jobs during the life of the lease, at the cost of about $500 each. There is the added advantage in the prefab of portability in the case of highway changes and the need for relocation. Petrola is presently conducting surveys with the aid of outside consultants to determine the current needs of motorists—size of properties, lounge, air conditioning, vending machines, food, and so on—to further improve the design of service stations. A new experimental station is scheduled for construction subject to approval of management.[3]

While the independent service stations in the past were not usually considered competitive with the major oil companies, there has been a quickening in tempo and a narrowing of differences in the station outlets. The manager of the Construction Department stated that the independents usually have a lower investment in consequence of having fewer facilities—limited number or no bays, and generally smaller dimensions. It is usual policy for the independents to buy or use cheaper properties with lower land costs. Some companies, formerly independents, such as Oklahoma in Chicago and Pate in the Midwest, have adopted prefabs. The independents spend the money allocated to service stations differently from the major companies. The layout of independent stations is designed to give the impression of large sales operation. More money is spent for pumps and lighting. The independents' increase in expenditures for lighting has forced the majors to increase their station lighting in order to be competitive for night operation.

Both major and independent have followed a trend toward increased underground storage to facilitate transport delivery to service stations. The increased underground storage has given rise to a problem for the operators in having to carry a higher investment in inventory. Consequently, companies have had to consider either leasing the station on a consignment-commission arrangement[4] (also known as lease-consignment) or accepting longer payment periods for loads of fuel.

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[3] Innovations by competitors were described in a recent issue of the *National Petroleum News*, December, 1959, pp. 112–18.

[4] When a service station is leased on a consignment-commission plan, the lessee is still an independent merchant, with the only difference between this and the standard lessee operation being that the company maintains title to the gasoline. The lessee tenders pump price and receives a commission on all gallons sold at the time of receipt of the next load of gasoline. The company of course maintains the right to post the price at which products are sold, as in a salaried or commission agency (bulk plant).

Petrola attempts through a standardized service station design and color scheme to push company identity to the public. The investment varies, but average figures indicate that a building costs $16,000, equipment $11,000, and land improvements $8,000 to $10,000. Another current trend is the increase in automotive mechanical work done at service stations. This may necessitate adding one more service bay, which will further increase the investment per station. With the cost of land added to the above figures, a Petrola station will range from $60,000 to $100,000 per unit. Typical independent stations will average $20,000 to $50,000 complete so that they are from one third to one half less than the cost of major-brand type stations.

Recent Developments

The management of Petrola in recent years has embarked upon a very ambitious and aggressive program which has resulted in a number of very significant changes. One of the first things undertaken was a stepped-up advertising and sales promotion campaign to secure, if possible, more than the company's pro rata share of the increased demand for petroleum products predicted for its market area. Newspapers, radio, television, outdoor painted bulletins and posters, farm journals, direct mail, driveway displays, and other recognized media were selected to augment the efforts of its sales force.

A special drive was initiated to increase the number and use of credit cards, which resulted in a 450 percent increase in a two-year period.

Following World War II, the company found its service station dealers selling a high volume of products but not securing satisfactory profits. Investigation of the situation led company personnel to the conclusion that several things were being overlooked by dealers, especially keeping adequate records. To remedy this situation, a dealer-training program was instituted. This program has been developed and improved and is now considered a very important part of retail distribution. Management feels that the training program has been helpful in reducing the amount of dealer turnover in service stations.

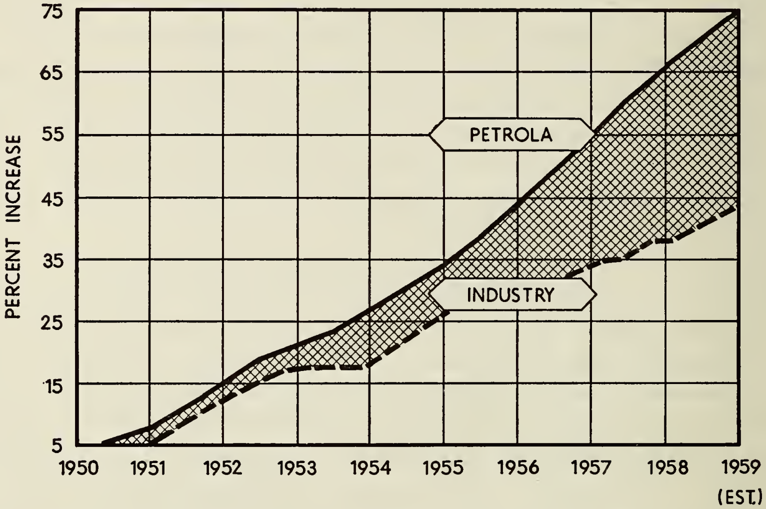
An industry spokesman recently expressed the change in the role of the service station dealer as follows: "The dealer was once mainly a mechanic, then principally a gas seller, but now he has to be primarily a manager. He must know how to handle labor relations, bookkeeping, finances, inventories, advertising, customer relations, credit, and all the other functions of a complex retail business."

The organization of the marketing function was studied. Two years later a complete reorganization was effected which involved a major move of personnel, offices, and authority to cope with the ever-increasing competition in the marketing segment of the industry. These changes brought about a sharper focus of responsibilities along product and functional lines.

In recent years leading competitive companies have introduced new premium gasolines to the market. These gasolines are enhanced by various types of additives. The spelling and pronunciation of the names of these additives would be difficult for many customers. Consequently some of the companies have adopted simplified means of identifying the new additives in gasoline. Some examples are: Flight Fuel, signifying the high octane of aviation gasoline, T.C.P., DR-2, and Boron. In addition to the additives for which various claims have been made, the octane ratings of the gasolines have been increased to answer the needs of the later-model cars. With considerable pioneering work in the field of gasoline additives, Petrola was somewhat tardy in the recent push in this direction by competitors; however, its Research and Development staff was busy developing what was considered a superior product. This new super gasoline in the premium grade was introduced in the late 1950's. Resulting increases in premium grade sales satisfied management of the product's superiority and competitive strength. (See Exhibit 2.)

EXHIBIT 2

Comparison of Petrola Branded Gasoline Sales and Industry Sales in Petrola's Sales Territory 1950–59



Petrola's Research and Development engineers have recommended that the company enter one or more branches of the petrochemical industry as an adjunct to present manufacturing operations. The action of the company on this recommendation has not been fully ascertained; but should the company choose to branch more heavily into the field of petrochemicals, additional marketing programing would be necessary.

Petrola has endeavored to expand its outlets and thereby increase its branded distribution and sales. During the three-year period beginning

1955, over 400 new service stations and bulk plants were opened. New direct marketing was begun in over 140 cities. This expansion represented 46.4 percent increase in the number of company service stations in a three-year period. A program of expansion is still being pushed by management.

Nevertheless, the marketing management of the company is aware that the average major price retail unit is capable of pumping approximately 400 percent more volume with but little additional cost, other than labor. They are also aware of the difference in cost of their type of service station and the cost of independent cut-rate outlets.

Sales Trends

One of the most noteworthy accomplishments has been the increase in branded gasoline sales in recent years. The increase in the Petrola territory has been much greater than the industry average, as indicated by the accompanying chart (Exhibit 2) which shows pronounced gains in the late 1950's. The year-to-year increases in total product sales are summarized below:

Year	*Year-to-Year Change in Total Product Sales (Percent)*
1956	2.8
1957	(2.7)
1958	11.5
1959	(1.2)*

* First six months only.

For 1958, sales of Petrola premium gasoline increased 11.2 percent over sales of premium gasoline the previous year. This was 9 percent greater than premium fuel increases reported in the industry average. Sales of all products in 1959 equaled 60,000,000 barrels. All-time records were set for total gallonage sales, station unit gallonage sales, gasoline, motor oil, automotive oils, industrial oils, greases, consumer specialty products, automotive tires, and accessories.

Industry Supply Situation

Looking in retrospect at the history of the oil industry, there exists many examples of wide fluctuation in the prices of products resulting from the periodic conditions of oversupply. These interludes have plagued the industry in recent years; in fact, the industry as well as Petrola was faced in 1958 and 1959 with an oversupply of all petroleum products. This surplus was further aggravated by low product prices caused in part by imports of foreign crude and products. As a result, Petrola changed its marketing strategy by reducing sales to the so-called "wholesale" market where profit realizations were the lowest and by concentrating on the marketing of its products in the branded channels of distribution; that is, through its own branded bulk plants and service stations and through its branded jobber channels where profit realization is greatest.

Since World War II, oil companies have been encouraged by the government to expand refining capacity as a national defense measure. This is understandable in view of the vital role petroleum plays in time of war; however, this expansion has magnified the oversupply problem. For example, the desire to operate the refineries at optimum production cost levels often yielded more output than could be absorbed in the branded channels and necessitated "dumping" excesses in the unbranded wholesale markets. This situation has contributed to the increasing numbers of independents or "cut-rate" operators. As one oil man put it, "We often meet our own gasoline coming back at us across the street."

Petrola is presently confronted with gasoline production in excess of branded channel requirements. In the case of gasoline, the imbalance has reached the ratio of 51 percent branded and 49 percent unbranded sales. The more gasoline dumped in unbranded channels, the more competition for dealers so far as price is concerned, as the independents typically undersell major outlets from 2 cents to 4 cents per gallon. Frequently price wars result from dumping; and until the market stabilizes, heavy losses often result for dealers and companies alike. The rapid growth of the independents and their increasing share of the market[5] has been alarming to major oil companies in general. The management of Petrola is especially concerned in view of its ratio of branded to unbranded gasoline sales.

Competitive Distribution Plan

Some of the other major oil competitors have organized and commenced operation of subsidiary companies. In effect this provides them with a dual system of distribution—the customary relatively high-cost system of marketing trademarked, advertised petroleum products and the competitive system of outlets designed to meet the price of the independents. Some major companies have acquired independents to provide this type of distribution for their excess production. Petrola's management is busy pondering the implications of this possibility for marketing the excess production.

Executive Comments

While the company has not resolved the problem of imbalance in branded versus unbranded gasoline sales, this problem has received consideration at various committee meetings. The opinions and viewpoints of several key executives in regard to this problem follow.

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[5] Independents reported to have 60 percent of the Minneapolis market and 47 percent of the Oklahoma City market.

Mr. Wilford Scott, Controller: The problem of the large percentage of unbranded gasoline sales puts the company at the mercy of the price cutters, which in turn affects the amount of crude runs through the refinery. When price doesn't cover costs you must reduce runs at the refinery. This would tend to raise production costs and necessitate storing crude we have contracted to receive. The market is very competitive and it seems that everyone else is dumping. Prices are uncertain and can easily drop to unprofitable levels. It is most difficult to make any long-range plans in view of this situation. It is my feeling that the problem can best be solved through the acquisition of distributors who have serivce stations or by building company stations. This latter step should not be done too rapidly. The most desirable would be the former. It seems that everyone else is getting into our market so we ought to consider other states in which to spread and add additional areas to our territory, although we are not in a financial position to go national at the present time.

EXHIBIT 3

Petrola Oil Company
Income Statement
1956–59

	1959	*1958*	*1957*	*1956*
Gross operating income				
Trade	$238,879,000	$239,507,183	$243,582,867	$227,196,589
Intercompany	6,798,000	5,153,388	4,966,683	4,910,956
Total Gross Operating Income	245,677,000	244,660,571	248,549,550	232,107,545
Operating charges				
Costs, operating and general expenses	215,973,000	218,488,282	215,435,596	196,469,428
Taxes	2,759,000	2,458,594	2,394,386	2,079,256
	218,732,000	220,946,876	217,829,982	198,548,684
Net Operating Income	26,945,000	23,713,695	30,719,568	33,558,861
Other income				
Profit or (loss) on sale of capital assets	494,000	(38,167)	3,561	41,350
Interest received	212,000	135,458	214,739	118,903
Discount received	...	146,798	241,730	267,491
Miscellaneous	110,000	148,707	340,362	110,982
	816,000	392,796	800,392	538,726
Gross Income	27,761,000	24,106,491	31,519,960	34,907,587
Other charges				
Interest paid	796,000	1,033,159	1,329,024	1,441,116
Discount allowed	1,102,000	1,006,510	1,077,470	984,640
Miscellaneous	15,000	...	2,000	73,500
Net income before depreciation and income taxes	25,848,000	22,066,822	29,111,466	31,598,331
Depreciation	7,575,000	7,104,223	6,156,223	5,683,953
Net income before income taxes	18,273,000	14,962,599	22,955,243	25,914,378
Provision for income taxes				
Federal	8,168,000	6,978,000	11,057,000	12,793,000
State	280,000	210,000	380,000	502,000
	8,448,000	7,188,000	11,437,000	13,295,000
Net Income	9,825,000	7,774,599	11,518,243	12,619,378

Some of our recent refining acquisitions would seem to offer a possibility of moving more toward the gulf. The use of a second brand appears very opportune. The sale of one of the refineries has been considered as one way to balance up the operations of the company, but this is difficult to do. Either a company wants a refinery to use existing crude supply in the area or a marketer wants to get more product through a refinery. To find either type of company is not easy nor are the results always desirable. There was a time when the company could make a profit on processing crude for other companies and turning back products for them to dispose of. The present oversupply problem renders this unprofitable. I should like to call attention to the lower net income of the company in 1957, 1958, and 1959 [see income statements]. This reflects lower product prices particularly gasoline and burner oils, greater depreciation at refineries, on new equipment, depreciation on the increasing number of service stations plus something for inflation reflected in general costs including wage and salary increases in recent years.

EXHIBIT 4

PETROLA OIL COMPANY
Balance Sheet
1956–59

ASSETS

	1959	*1958*	*1957*	*1956*
Current assets				
Cash	$ 11,688,000	$ 11,852,031	$ 20,780,508	$ 17,380,298
U.S. government securities at cost	...	1,986,600	986,452	6,975,775
Notes and accounts receivable	17,717,000	17,770,455	18,124,120	18,846,978
Reserve for doubtful items	(778,000)	(492,709)	(266,238)	(178,847)
Inventories				
Crude oil	417,000	426,739	5,166,380	7,179,738
Refined products	30,931,000	29,680,146	33,726,298	32,325,753
Materials and supplies	4,367,000	4,158,206	5,454,250	5,663,940
Total Current Assets	64,342,000	65,381,468	83,971,770	88,193,635
Other assets				
Notes and accounts receivable due after one year	2,146,000	1,413,066	1,287,474	1,750,034
Miscellaneous	50,000	52,562	11,036	9,686
Total Other Assets	2,196,000	1,465,628	1,298,510	1,759,720
Prepaid expenses and deferred charges	1,758,000	897,544	802,039	875,625
Fixed assets				
Property, plant, and equipment				
Refining	92,180,000	89,403,276	79,534,239	69,986,165
Marketing	41,629,000	35,860,490	37,081,975	33,838,346
Transportation	24,808,000	29,635,465	29,252,739	28,807,349
Miscellaneous	659,000	...	...	...
Total Fixed Assets	159,276,000	154,899,231	145,868,953	132,631,860
(less reserve for depreciation)	(66,657,000)	(63,059,289)	(56,829,186)	(52,596,898)
Net Fixed Assets	92,619,000	91,839,942	89,039,767	80,034,962
Total Assets	160,915,000	159,584,582	175,112,086	170,863,942

Liabilities and Shareholders' Equity

	1959	*1958*	*1957*	*1956*
Current liabilities				
Accounts payable and accrued liabilities	$ 12,775,000	$ 11,912,975	$ 25,753,005	$ 23,708,523
Due parent company	...	2,154,040	558,861	417,034
Provision for federal and state taxes on income	4,955,000	5,072,267	7,999,269	11,300,677
Total Current Liabilities	17,730,000	19,948,282	34,750,135	36,020,234
Long-term debt				
Notes payable	48,000	...	...	...
Total Long-Term Debt	48,000	...	...	...
Deferred incomes and reserves				
Reserve for major repairs and advertising	875,000	809,000	439,000	594,000
Total Deferred Income and Reserves	875,000	809,000	439,000	594,000
Shareholders' equity				
Capital stock, $1 par	51,000,000	51,000,000	51,000,000	51,000,000
Surplus	91,262,000	88,636,300	89,361,951	83,343,708
Total Shareholders' Equity	142,262,000	139,636,300	140,361,951	134,843,708
Total Liabilities and Shareholders' Equity	160,915,000	159,584,582	175,112,086	170,863,942

Mr. George Thomas, Senior Vice-President, Production: As long as we are an integrated company we do not get any new money until we squirt the gasoline into someone's car and get money for it. More profit comes from branded sales so we must strive to get the most we can. When company profits are good the company is able to pay more for crude and this helps my operation. If marketing doesn't make money, pressure is put on the production department to sell our crude for less which lowers our income and gives our department a less desirable picture. The closer we can get to the ultimate consumer with our branded products the more money we will have for the company till; therefore, I would like to see a reduction in the unbranded ratio. So far as solving this problem, it seems to be not a case of black and white, and perhaps we should follow to some degree all of the alternatives. I am not in a position to advise here as I do not have all the facts. I do know, however, that the idea of a second brand has been successful for some companies and would appear to be a good program to meet the small independent competition.

Mr. Ralph Thompson, Vice-President, Wholesale Sales: Some people might feel that I would be against the reduction of unbranded gasoline sales since it is my job to dispose of these products, and by reducing them it would put me out of my job. There would still remain a host of other products (waxes, burner oils, LPG, etc.) which would keep me busy selling in the wholesale markets. While I favor the idea of eventually getting all gasoline sold under our own company brand, I have some ideas of my own as to how this should be accomplished. First, I think the company would do well to make some processing deals with other large major oil companies who have refining capacity, but not in the area of our refineries. This in effect would use up some of our refining capacity, cut down the amount of products we would have to dispose of ourselves, and still keep the refineries operating on stream at an optimum level. Although we have a large supply of crude produced by the company, it is still necessary to buy additional crude to keep our refineries operating at optimum levels and so my proposal would reduce crude purchasing also. In the meantime I would proceed to build inexpensive skid stations of prefab portable construction with an approximate cost of $6,000 each. These stations could be built with a lot of glass and used primarily in the South. I would introduce a second brand for these outlets and merchandise them like the independents. Various locations could be leased with an escape clause so that we could pull out of the locations that were not desirable. These units should produce a minimum of 20,000 gallons a month. Their location should be shifted until they yield this volume. If the location proved very worthwhile, the station could be converted to Petrola brand by adding the necessary facilities to make it equal to our regular branded outlets.

MR. PETER MALONE, ASSISTANT GENERAL COUNSEL: As the company proceeds to reduce its unbranded sales through acquisitions, it will not likely incur any problems where individuals are concerned; however, in the case of making acquisitions from corporations, Section 7 of the Clayton Act must be considered. This section prohibits the acquisition of assets of other companies where the effect is to lessen competition or create a monopoly. Where the size of a town is too small or the size of the acquisition is too small, there is usually no problem. In the case where a large acquisition is made involving a large area from another major operator and our company was not in the area, it would not raise a problem as it would not affect the major marketer position in that area. If the acquisition involved an independent with widespread distribution, while basically it would not eliminate competition, the changing of brands and the elimination of a private independent brand may not encounter the opposition of the F.T.C.; however, the Department of Justice has not approved some mergers of this type, namely, the case of Leonard Refinery and Standard Oil Company of Ohio. A question may be raised in the case of a merger of major brands which are competitors in a substantial trade territory as to what constitutes a substantial effect on competition. Therefore, if the company desires to expand by acquisition, there must be consideration given to the implications as regards Section 7 of the Clayton Act. Another question involving price differentials between sales to different buyers is posed in the matter of operating with two brands, where the second brand is used to compete directly with independents. The differential to the company's own brand may be justified by additional services involved. Nevertheless this question hinges on the provisions of the Robinson-Patman Act and operations would have to agree with the act.

MR. CHARLES HUGHES, ADMINISTRATIVE VICE-PRESIDENT: The goal of the company ought to be a balanced marketing of refinery capacity in terms of branded gasoline products. In our Southern territory we should perhaps move at the independent price level using a second brand in a segregated company to accomplish this goal. Elsewhere in our territory we could use our status quo procedure, watching marketing trends most carefully, mindful that prices, like water, seek a common level and that signs now point toward a reduction and possible eventual elimination of the differential in price between the branded and unbranded marketer. In virgin territory, of the three principal alternatives, namely, supplying independent distributors through a second brand, building new company service stations, and the acquisition of other company distribution through purchase or lease, the first would seem to be the least expensive route and the fastest way to build branded sales in motor gasoline and reduce the imbalance confronting us at present; although, very realistically, all three methods would probably have to be used to develop a permanent home for our motor gasoline production, thus eliminating open market transactions of unbranded products.

Mr. John Paul Jones, Financial Vice-President and Treasurer: My philosophy of marketing would suggest that the company should devote more effort in intensive rather than extensive programs and avoid market expansion. We should fill in the blank spots that exist in the present territories. I think this approach would maximize profits for the company in the long run. With respect to the problem of imbalance of sales which the company is concerned with, several alternatives could be followed. For example, we could sell a refinery. This would reduce the supply of products; in fact, it would just about balance the situation. We would then have additional working capital which could be invested, and perhaps some of this could be used to advance an intensive marketing program to build branded sales. I would be inclined to approach this unbranded situation by continuing to build company brand service stations, but of course this is a slower route to follow. Again I would favor doing this on an intensive rather than extensive basis. We are a regional marketer and should develop our hinterland market. There are better net-backs along our pipelines and away from the rivers and cargo markets. We should attempt a second brand program along the rivers and do this on the fringe of our principal markets. Seems to me that we could line up some independents already in business, provide them with a brand, give them some advertising helps, assure them a continuity of relationship and act in the capacity of their regular supplier. This would require a minimum investment on the part of our company. The alternative to using a second brand would be to build the service stations ourselves and adopt independent merchandising practices. Another way to approach the problem of how to increase branded gasoline sales, would be to devise some means to move more gallons through the regular company branded service stations. And here I favor using some kind of a graduated margin as an incentive for the dealer. As the dealer expands his volume he reaches certain points where he has to increase his overhead by adding more help and other factors which increase his costs. Therefore, he should be encouraged by a higher margin to obtain a higher volume. Perhaps we could devise a plan whereby the dealer would get 5¢ up to a certain volume and then 6¢ over that figure and even 7¢ over still a higher figure. I know of a case where one of our stations was pumping 25,000 gallons a month and decided to put in stamps and his volume increased to 40,000 gallons, but he found he was not making as much net profit as he had with 25,000 gallons. He discontinued the stamps and has been cutting back to get to a more profitable operation. If he had had a graduated margin he probably could have maintained his profits. From the company standpoint, if this dealer could have maintained his double throughput, it would have saved the company having to build another $60,000 to $100,000 station to increase branded sales.

Mr. Richard Smith, Vice-President, Supply and Transportation: While normally the branded gasoline sales are more profitable than unbranded gasoline sales, there are times, such as periodic price wars, when the wholesaling of unbranded gasoline is more profitable than supplying branded outlets at subnormal prices. Then to, there may be times when a wholesale buyer of burner oils, asphalts and LPG products may also wish to buy some unbranded gasoline, so that perhaps some unbranded gasoline may be necessary to meet wholesale customer requirements. On the other hand, were the company successful in shifting all gasoline sales under branded distribution, perhaps the wholesale customers may not be adverse to buying our related products and securing their gasoline elsewhere. The ultimate decision should be based on balanced operation for the company.

MR. JOHN ADAMS, VICE-PRESIDENT, MANUFACTURING: Our refinery profit is based on wholesale prices plus a small fee. Historically, the branded gasoline sale prices have been higher than the wholesale or unbranded sales. As branded sales increase, our wholesale sales decrease and profits tend to move up. On the other hand, as branded sales go down, wholesale sales must go up with the same refining capacity and thus profits are reduced which has its effect on our capital expenditures budget so that progress in improving refining operations is retarded. We ought to expand branded sales and perhaps sell some under a second brand. Perhaps we should buy out some independents as some other major companies have done. I do not feel we should sell any refineries as refineries are making money for the company, and they will be needed as we continue our expansion in the petrochemical field. Some people feel that a wholly integrated company should produce, refine, and market the same quantity of products. That is, they would produce the amount of crude necessary to refine the amount of products that would be entirely utilized by their own marketing channels. This is referred to as completely balanced operations. As long as our refineries are making a profit I see no reason to sell them. Then too, our pipelines are also making a profit in conjunction with their operations with the refineries. It would be my feeling that the company should let the production department build up to refining capacities rather than sell a refinery. Problems in the gasoline market can't be cured by our company alone, and therefore we should proceed in a reasonable manner in dealing with these marketing problems.

MR. I. A. SMOOT, VICE-PRESIDENT, RETAIL SALES: The long-run objective of the company is to reduce the unbranded sales to a minimum figure. This is obvious because the company makes more profit per gallon on branded sales. The company has already taken several steps to reduce the unbranded sales and should continue its efforts in this direction. In resolving the unbranded sales situation, it would be impractical in my opinion to move in the direction of expanding the size of markets covered because of supply and transportation conditions and also the location of our refineries. From a practical point of view, we must build more branded service stations—fill in the bare spots in existing territories and gradually expand into adjacent areas where we could be competitive. We could step up the expansion program if the company would pour more money into this additional representation and still not be overloaded in the number of service stations. Stepping up branded expansion with an adequate expansion budget would enable us to increase the amount and use of credit cards, build customer acceptance, and increase customer patronage of our Petrola service stations. Such a program would give us more benefit from each advertising dollar spent. In fact, through developing our distribution on an intensive basis, we could increase the sales volume without increasing the advertising appropriation. In fact, I believe such a plan would produce a greater profit realization. The leasing of service stations and bulk plants from competing jobbers, and incorporating their distribution in disposing of Petrola products appeals to me as a worthwhile approach in converting the unbranded sales to branded sales. Another alternative would be the acquisition of other jobbers through outright purchase. I do not feel that a second brand is the answer, and I question that this has proved altogether successful for those who have adopted one. I believe this is particularly true where a second brand is used in the same area as the primary brand.

MR. ROGER WILLIAMS, PRESIDENT, REFINING SUBSIDIARY: The situation facing the company is a case where refining capacity presently exceeds both crude production and branded market demand. This means that the company has to buy additional crude to maintain its refining operations; and when this crude is refined, it means that the surplus products must be sold in the wholesale markets. Many refineries have been forced out because of not having sufficient low-cost crude or because of their inability to obtain good return on the sale of products marketed. Being forced to sell in the wholesale markets is not a very desirable situation. The only time major buyers purchase is when they can't produce sufficiently to satisfy their requirements themselves. What the company really needs is to acquire more controlled outlets for gasoline and burner fuels. We are beginning to utilize and will utilize more intermediate distillates in our petrochemical business which will reduce our products now being sold on the cargo markets. For example, we are now producing larger amounts of tetramer, benzene, and other similar products which tend to diminish the amount of gasoline we are compelled to sell in the wholesale markets. Of course, at best they only absorb a small percent of total production which still leaves the company in need of finding a permanent market for the products in excess of their branded requirements. How this should be done, I will leave in the hands of the marketing department as I am not a marketing man.

MR. PATRICK MACDOUGAL, MARKETING CONSULTANT: When you have to dump products on the open market you are at the mercy of spot buyers, which puts you in a very unfavorable position. At the same time, the payout for branded service stations isn't good. Therefore, the company wants to move slowly in expanding this type of distribution. A really happy situation exists when the production department supplies the crude sufficient to meet refinery requirements, and in turn the marketing department is able to absorb all of the refinery output through controlled channels of distribution. Fortunately for some of our competitors, they have achieved this ideal operating situation. If the company could make a satisfactory deal in selling one of its refineries, it perhaps would be O.K. and would tend to resolve the unbalanced condition. However, it is hard to find a satisfactory buyer and so this, while it may appear to be a desirable solution, does not offer much in the way of a practical possibility. The problem to me is how fast the company should build branded service stations. Everyone else is building service stations, and of course there is too much crude being run by the industry which makes it bad for this and other companies as well.

MR. JOHN S. MILL, ECONOMIST: I think that marketing policy, or any other policy, in a company should be predicated upon an understanding of what is going on in the general economy, in the industry, and within the company itself. Decisions which are appropriate in an expanding industry will not be appropriate in a mature industry. This is not to say that it is impossible for a company to be a growth company within a mature industry, but it does mean that management decisions must take into consideration the industry environment within which the company must exist.

It is my opinion that the petroleum industry underwent a basic change sometime around 1956 and began the transition from a growth industry to a more mature industry. I feel that this fact is reflected in all segments of the industry.

The crude producing segment of the industry is having difficulty in adjusting to a diminution in the rate of growth in the demand for crude. The result has been a weakness in crude prices, heavy inventories, and general overproduction despite vigorous proration efforts on the part of state governments.

The refining segment of the industry for years has predicated its capital expenditures upon the rate of growth for demand of petroleum products which averaged 5 to 6 percent per year. The lag between capital appropriations and the consequent placing of production units on stream required that refinery production lead product demand by three or four years. When the rate of increase in product demand began to diminish in 1956 and 1957, the refinery segment of the industry found itself with 15 per cent more capacity than could be possibly used. The economics of refining are such that a heavy penalty, in terms of high unit costs, is assessed against any refinery not running at full capacity. This, plus the presence of heavy crude inventories, has led to consistent overproduction of petroleum products by the refineries.

The marketing segment of the industry has faced the job of attempting to market this vast oversupply of products. The result has been that the product prices have not increased as rapidly as cost of production or cost of marketing. This problem has been compounded by a rapid increase in the price of service station sites, in construction cost for service stations, and in service station operating cost. An added burden has been the resistance of the purchasers of petroleum products to price increases existing at the same time that taxes on these products have grown rapidly. The result has been a marked decrease in the profit per gallon which the marketers have been able to obtain for their products.

The low-price marketers stepped into this picture and took advantage of the fact that refinery overproduction leads refiners to dump large quantities of petroleum products on the market at "bargain" prices. They coupled this advantage in cost of goods sold with a stripped-down operation which omitted many of the services traditionally provided by many of the service stations. They were, in this manner, enabled to provide gasoline at prices several cents per gallon lower than the major marketers could charge. The result was that the low-price marketers enjoyed a large volume of sales per station which further reduced their unit cost of operation.

I, therefore, feel that this company, and all major oil companies, must face up to a problem compounded of overproduction, surplus refining facilities, and hard hitting, low-cost marketing competition by the low-price marketers.

The major marketers simply have to recognize the fact that the low-price marketers are successful because they are giving an important segment of the motoring public exactly what it wants. To me, the answer is obvious.

Major marketers must face the fact that it is no longer valid to contend that every car owner must have a neighborhood gasoline station within five blocks of his home run by good old Bill who bowls in the league every Monday night and who is a member of the Kiwanis Club. Typically, these neighborhood stations are low volume, high-cost operations. They simply cannot compete with the large volume units owned by the low-price marketers and while our car owner may still bowl with good old Bill, he often buys his gasoline from the man who sells it for a lower price.

It is from this evaluation of the industry that my proposal of the policies which this company should follow stems. I feel that basically we should aim for the high investment, high gallonage units. We can afford to pay the price that locations appropriate to such units will cost. This reflects the fact that in station operations, as in most other operations in the oil industry, fixed costs make up the major share of the cost of station operations. The only way to get cost per gallon down is to achieve a high volume of sales in each unit. We have found that in many cases, a 20 percent increase in station sales will bring about a 100 per cent increase in station profits.

I further favor abandoning low gallonage units, even if their profit and loss statement indicates that they are making a modest profit, so long as their profit per dollar invested is below that of large units. The capital made available by the abandonment of these units can help foot the bill for building the larger units.

It follows from this, in my view, that rather than attempting a more intensive development of our present marketing area, we should attempt to expand the geographical area which we serve. This reflects the fact that station sites appropriate to the high gallonage units are not as common as are those which are adequate for low gallonage units. In order to invest our service station capital funds wisely, we must expand the area in which we operate.

Along with this emphasis on high gallonage units, we must make every effort to streamline our entire marketing operation to the end that distribution cost per gallon sold will decrease. Either this company must go this route or face the disadvantage which results from attempting to meet the competition of lower cost competitors in an industry plagued with overproduction and heavy price competition.

Reliable Electric Company[*]

In mid-May, 1960, Mr. L. T. Lyle, a management consultant, received a telephone call from Mr. Randolph Mills stating that he and his partner, Mr. Wesley Nance, would like an appointment to discuss the operations of Reliable Electric Company. The mutually acceptable date of June 8 was set for the appointment.

Mr. Lyle had known Mr. Mills for about two years. They had participated in educational programs, degree and short-course, offered by the local university. He considered Mr. Mills to be the promoter-type.

FAMILY BACKGROUND AND PERSONAL CHARACTERISTICS OF PARTNERS

Mr. Randolph Mills

Mr. Mills' father was born in Strasbourg, Germany, and moved to the Amana Colonies in Iowa in 1871. He received architectural training under the Amana apprenticeship program. He owned and operated a sash and door factory in Iowa until his death in 1930.

Mr. Mills' mother was born in Iowa. She taught at the elementary and high school levels. Following her marriage, she stopped teaching and became a housewife until her death in 1943.

With their multilingual ability, his parents corresponded with various relatives in Europe. The father had a flair for show business and seriously considered purchasing an interest in the Ringling Brothers' Circus, but never did so.

One of nine children, Randolph Mills was born in Iowa in 1916. His brothers are mechanically inclined; two operate sash and door factories and a third, a salvage yard.

Mr. Mills' parents expressed no career preferences for him. Early in life, he aspired to become a doctor. He completed his high school education in Iowa. At a pre-enrollment conference, the president of the University of Iowa tried to dissuade Mr. Mills from entering the medical school because of Mills' low high school grade average and lack of funds.

Mr. Mills said that his partial loss of hearing accounted for his scholastic deficiencies. Prior to incurring his defect, he was an "A" student. He had almost recovered his full hearing by age 26, but still has difficulty in hearing subdued conversations.

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[*] Prepared by Lyle R. Trueblood, The University of Tulsa.

Mr. Mills went to an engineering school but did not graduate. He also took a course combining sales training and engineering from the International Correspondence School and the LaSalle School of Business of Chicago.

Mr. Mills was a Toby comedian with Hatcher's Traveling Dramatic Show in the summer of 1935. During the summer months of 1936–39, he was an advance booking agent for an Iowa carnival. He built, produced, and put on the road a dramatic show, with a cast of 14, in the fall of 1940. This venture was successful, and he recovered his investment in the first year. In 1941, because of the war, he sold the canvas and paraphernelia to a self-styled fundamentalist minister for a revival.

From 1931 to 1938, Mr. Mills apprenticed in the electrical industry and earned his journeyman card in 1940. He left a position of journeyman electrician in an Iowa factory with a weekly salary of $119.00 to enter the construction business in the fall of 1941. He accepted a job as office boy with a Tulsa electric supply concern for $18 a week. Three months later, a promotion to estimator followed. In 1942, he enlisted for three years in the Sea Bees. Upon release from service, Mr. Mills was employed by a Tulsa electrical contractor. Later he joined another local electrical contracting company and remained with it until he purchased the Reliable Electric Company in 1948.

Mr. Mills' wife graduated from the Smith-Hughes program of vocational home economics at Oklahoma State University in 1943. Until their marriage in 1945, she taught in Oklahoma high schools. They have two adopted children, a seven-year-old daughter and a three-year-old son.

Mr. Mills appraised himself as an optimist. He stated that he does not like detailed work and that he is inclined "to go off the deep end" at times. Regarding his pastimes, he is typically interested in research and can literally spend hours at a time on it. Concerning books, he is not usually interested in those of "some depth," but instead prefers light reading. He often reads the latter type of book from cover to cover in one sitting.

Mr. Wesley Nance

Mr. Nance was born in Bristow, Oklahoma, in 1927. His father was a dry goods merchant, and his mother a housewife. They wanted him to go to college to obtain a degree. The father's career preference was for his son to go into merchandising, but this was unappealing to Wesley.

Since childhood, Mr. Nance was always interested in electricity and hoped to enter engineering school upon high school graduation. He went to a junior college for one year, and studied electrical engineering at the University of Oklahoma for one year. He also took a one-year course in electricity at a technical institute in Kansas City, Missouri.

Mr. Mills characterized his partner as being a pessimist, who did not mind detail, and who was inclined "to go slow and easy."

MEETING ON JUNE 8, 1960

On June 8, 1960, Mr. Mills, Mr. Nance, and Mr. Lyle met at the latter's office. Mr. Mills was the primary spokesman for the partners.

Mr. Mills stated that he and Mr. Nance disagreed concerning the most appropriate course of action for them to take, and they were seeking the counsel of a disinterested third party.

DISAGREEMENTS BETWEEN THE PARTNERS CONCERNING RELIABLE COMPANY'S OPERATIONS

Mr. Mills and Mr. Nance disagreed concerning some aspects of Reliable's operations. However, such differences were not serious enough to cause the partnership's dissolution.

Mr. Mills favored an expansion program and recommended an extensive sales promotion program for 1960. On the other hand, Mr. Nance preferred to delay expansion until the firm reached a more solvent financial position.

Mr. Mills liked the "package" approach of stimulating business. Such an approach was characterized by cooperating with various segments of the contracting industry to obtain jobs. In analyzing an unsuccessful trial of the "power-up" program (see p. 567), Mr. Mills put the blame on "lack of contacts," Mr. Nance, and salesmen's lack of technical knowledge. Furthermore, Mr. Nance felt that Reliable should confine itself to electrical work only.

FORMER OWNERSHIP OF RELIABLE COMPANY

Reliable Company was founded by Mr. Russell Peters, who operated the business successfully for about eight years. According to Mr. Mills, Mr. Peters' personal wealth was over $150,000 when the firm was sold in 1948. Operations were so profitable during 1944–47, that Mr. Peters was able to accumulate 90 percent of his wealth.

PURCHASE OF RELIABLE COMPANY

Mr. Mills, along with a limited partner, Mr. Osborn, paid $2,600 each for the purchase of Reliable Company. The assets included consigned materials, but excluded goodwill. Using the firm's accounts receivable as collateral, they obtained $1,500 working capital from the Third National Bank.

The partners purchased two other companies, the Exeter Electric Company and the Fidelity Electric Corporation, in the first year. Thus, Reliable consisted of the assets of three companies.

In 1953, Mr. Mills went into some oil drilling ventures. Initially he was extremely successful, but disaster later struck in the form of oil exhaustion, and $90,000 debts were incurred. By making heavy withdrawals for six years from the business, Mr. Mills liquidated $80,000 of these debts. Irrespective of these obligations, he stated that he had acquired sizable amounts of life insurance and other intangibles.

In 1957, Mr. Osborn withdrew from the business, receiving his investment and some tax-free benefits resulting from the partnership. Mr. Nance, who had been a warehouseman with Reliable Company since 1951, became a partner on a 10 percent basis.

Mr. Mills stated that Reliable Company was successful until 1953, because a seller's market existed and there were fewer competitors. The number of electrical contractors has doubled in Tulsa since 1953. He stated that national statistics for electrical contracting indicated, during the period from 1948–53, that the percentage of net profit before taxes to net sales was about 4 percent while this ratio was now about 1 percent. In 1960, only one electrical contractor, of the 19 members in the local NECA chapter, claimed that he made an adequate return on his investment.

Mr. Mills said that in 1959, Reliable Company did not have sufficient business. But, during the first half of 1960, it had obtained a $450,000 negotiated contract, portions of which should last for about two and one-half years. This volume should enable him to liquidate his debts.

No great difficulties in the company were anticipated until the winter months of 1960–61. At this time, construction of the Euclid Reservoir, the major project of the firm, will be curtailed heavily.

RELIABLE COMPANY'S FACILITIES AND LOCATION

Reliable Company's offices were located in a reconverted residence near downtown Tulsa. Mr. Nance and the firm's secretary shared one room and Mr. Mills occupied another. A warehouse was on the rear of the lot.

Mr. Nance believed that their central location was advantageous, because of its equidistance to customers, and a large amount of business was done downtown. However, Reliable Company was not operating at capacity.

MARKET AND SALES

Fifty to sixty percent of the volume of Reliable Company consisted of small repair and modernization jobs for commercial and industrial owners. New construction of commercial and industrial facilities accounted for the remainder of the volume. Little work was done for residential owners. The jobs were obtained from general contractors, architects, and engineers. Sometimes, in contacting architects and engineers, Reliable obtained the bid before the general contractor was awarded the contract. Also, some contracts were procured because

Mr. Mills was able to remove them from a "competitive bidding" list.

Predominantly the company's business was done on a negotiated rather than a bid basis. From 1957 to 1959, probably less than 25 percent of the volume was obtained through bidding. An important characteristic of Reliable Company, and the industry, was that the sales in one year were partially the result of contracts made in the previous year or two.

Mr. Mills and Mr. Nance stated that they did not wish to deal with general contractors or any customers who were interested in price only. "We didn't want to be just price competitors; we were seeking only a certain type of business."

To illustrate the "quality" business image which Reliable Company was trying to maintain, Mr. Nance refused jobs where the customer did not want to put in the installation the way that he thought it should be. Another example was a journeyman electrician's comments quoted by Mr. Mills. The electrician, who had worked for the firm in 1958 and returned to its work force in 1960, remarked: "It is certainly good to be back with a firm that wants to do high-quality work like you do." Mr. Mills stated that all but one or two Tulsa electrical contractors were engaged in a "price war," which resulted in work of inferior quality.

Reliable Company had over 400 accounts. There had been stability in most of them due to friendships, previous acquaintances, and to a certain degree, pricing. However, three major accounts had been lost. One of these was a large chain grocery firm. The reason cited for losing it was the size of the company, and the difficulty of maintaining a stable relationship with its officials. Reliable Company, which was "union shop," also lost a manufacturing client because it went "open shop." No accounts were lost because of customer complaints.

Major accounts were important to the Reliable Company because of their volume and their value during slack periods. Two of these accounts, for example, represented $12,000 and $20,000 annual volume. To offset the decline in construction during the winter months, Reliable Company relied on electrical maintenance jobs.

Residential Construction

Mr. Mills felt that Reliable Company was handicapped in dealing with residential builders. They preferred "open shop" electrical contractors.

Furthermore, the types of materials used by Reliable Company were priced too high to be used in houses. To illustrate, the lowest price switch that the firm used was 29 cents, while predominantly residential contractors install 9-cent switches. In fact, considering the $7.00 hourly service call charged, Mr. Mills preferred to use an 80-cent switch.

Arrangements with Appliance Dealers

Reliable Company contracted with three large customers, two department stores and one automobile equipment distributor, to install their home electrical appliances. It lost the department store accounts to a nonunion contractor, probably because of a lower price offer. However, their appliance salesmen still referred the customer, when they were handling the installation, to Reliable Company because of its quality work.

"Power-Up" Program for Commercial Enterprises

A national electric manufacturer had a "power-up" program and assisted Reliable Company in selling owners of commercial enterprises on remodeling or improving their electric facilities.

The approach was for a Reliable Company salesman to go into a store, and from his knowledge of trade association statistics, determine approximately the sales and profits of the business. He projected what the earnings should be if changes in the building and floor area were made. An architect working for Reliable Company, a general contractor, and other subcontractors, prepared an attractive brochure for the merchant.

Only one account, a small jewelry store, was obtained. Mr. Mills admitted that one of the problems encountered was the merchant's resentment of Reliable Company salesmen knowing so much about his business. Another difficulty was that Reliable Company lacked prestige.

Residential Power Program

Mr. Arthur Quincy, while working at the University of Tulsa toward a B.S. degree in business administration, had a part-time sales job with Reliable Company. From early May until mid-July, 1959, he contacted potential residential customers for electrical work. Previously the local NECA chapter had another salesman engaged in the same effort for its membership. Mr. Quincy wanted some public relations experience and felt that this was an excellent opportunity.

Mr. Lyle was well acquainted with Mr. Quincy, having had him as a student. He interviewed him on July 11, 1960.

Reliable Company was associated with an Oklahoma electric utility and a national utilities trade association in a "power-up" program for residences. Leads were obtained from the utility, the Tulsa Home Show, the local NECA chapter, and Reliable.

Mr. Quincy was paid a weekly salary. If the program had succeeded, he would have received a commission. He felt that his lack of technical knowledge was a definite handicap in pricing. Several jobs were lost because the bids were too high. To assist him, Mr. Nance developed a book of standard rates on wiring and receptacles.

The customer usually had a specific electrical job, such as an additional outlet, in mind. Mr. Quincy always tried to entice him to improve the basic wiring and to have additional electrical work done. He believed that sometimes the customer was "shocked" in having a $10 job increased to $200.

Mr. Quincy used training materials provided by the utility and the NECA. He felt that he needed a year or two of technical training to have succeeded. He disagreed with Mr. Mills' opinion that only sales techniques were necessary. He sold only one job. The arrangement between the partners and Mr. Quincy was terminated but their relationships remained amicable.

Reliable Company had a good reputation in the industry for quality work, but Mr. Quincy wondered whether there was sufficient demand for it for the firm to succeed. He evaluated Mr. Mills as a good "contact" man and Mr. Nance as being almost overburdened with detail.

Mr. Mills believed that lack of contacts was the major handicap faced in the commercial and residential programs. According to him, if Reliable Company originated the idea, there was a market for the services. However, many of the residential leads, obtained from exhibits at the Tulsa Home Show, were composed of individuals who wanted to win a door prize, but did not want electrical work done.

Market Potential

According to Mr. Mills, nationally electrical contractors obtained about $4 billion of a $18 billion market potential. Public service companies, oil companies, manufacturers, general contractors, and individuals accounted for the remaining $14 billion. Mr. Mills believed that electrical contractors should attempt to obtain a share of the latter market rather than to be "competitive" within their present market. The market potential was expected to double within the next decade, and the challenge of electrical contractors was to obtain their share, and increase it, of this potential.

There are three important functions of a successful electrical contracting firm: sales, business administration, and technical knowledge. Mr. Mills felt that the sales function was neglected at Reliable Company, but admitted that the industry was characterized by having few good salesmen.

Mr. Mills questioned his ability to sell. The $14 billion market was a higher-caliber business than that ordinarily obtained by electrical contractors. He admitted that he had a lower status than major oil and manufacturing executives, who determined how their company's electrical work should be done. He belonged to the Harvard Club, but could not afford the Southern Hills Country Club.

Before attempting to sell the services of Reliable Company, Mr. Mills preferred to have someone else sell the interested party on the feasibility of having the electrical work done by an electrical contractor. Also he recognized the difficulties in dealing with company executives who may "lose" a half-million dollar budget if the decision was made to "contract out" the electrical work.

Mr. Mills made a valuable contact with a Tulsa manufacturing executive. They and their wives were planning to play bingo at the Tulsa Country Club. He did not enjoy bingo or any card game, but participated if it meant potential business for Reliable Company.

He had also attempted to work through a prominent Tulsa executive of an automobile supply firm, a major account of Reliable Company. This executive did make some contacts for Reliable, but few had been productive. Mr. Mills wondered whether he could entice someone, perhaps a retired company president, to become a salesman for the firm. He interviewed four men in June and July, 1960, for a commission sales position, but so far had been unsuccessful in obtaining anyone.

Advertising

According to Mr. Mills, the NECA recommended that a contractor's advertising ratio, advertising to labor and materials costs, should be about 2.5 percent. Even though Reliable's ratio had not been this high, it had exceeded the average for the electrical contracting industry.

Mr. Mills admitted that recent advertising programs had been unproductive. To illustrate, the services of a Tulsa advertising agency were obtained. The latter mailed 1,000 cards to potential customers, but only 1 percent of them were interested in Reliable's services. The agency's fee was $1,000.

EXHIBIT 1

Prepare for the Hot Days Ahead with a
SUMMER WIRING
CHECK-UP

CHECK LIGHT SWITCHES—REPLACE WHERE NEEDED
CHECK RECEPTACLES—REPLACE WHERE NEEDED *$ 8.95*
CHECK AND OIL ATTIC FAN *plus*
CHECK AND OIL FURNACE *parts*
INSPECT FUSE PANEL

For Appointment Call
RELIABLE ELECTRIC COMPANY
GRand 8–9765 815 North Louvre

In April, 1960, the partners prepared their own advertising. Cards, illustrated in Exhibit 1, were sent to about 200 of the company's residential customers, and a 6 percent return was realized. No follow-up had been made on these cards by July, 1960.

Queries Concerning Sales

Mr. Mills asked these questions concerning sales at the June 8, 1960, meeting:

1. Does a person sell the product or does he sell the benefits of the product?
2. Should we continue business as in the past and not spend money for experimental work—advertising, personal selling—or should we go slower in paying off the indebtedness and put it into sales efforts?
3. Would it be feasible to interest a retired, successful salesman or a former president of a company in selling for our firm? Would he work on a commission basis?

ADMINISTRATION

Mr. Mills took care of the administration of Reliable Company, and Mr. Nance, the technical function. Mr. Mills felt that one man could handle only one particular department. He described his position as being concerned with financing, assigning work to the secretary, and contacting potential customers. Mr. Nance supervised the foremen on the jobs. However, the electricians reported to either of them.

According to Mr. Mills, he was not spending his time as effectively as he could and should. Reliable Company's financial situation and sales problem account for this inefficiency. He admitted that there are times when he did not want to do anything. To get away from the business, he went out to a job or went home. But rarely was he able to remove his company's problems from his mind. To illustrate, his experiences at a recent Tulsa Oiler's baseball game were such that he did not remember certain "routine" innings because he was so intent in thinking about the business.

On Monday, June 20, 1960, Mr. Nance outlined a typical day, Monday through Friday, as he spent it. Sometimes he came to the office on Saturday mornings too. (See Exhibit 2.)

Staff of Firm

Reliable's staff consisted of the two partners, an office girl, and a warehouseman. The latter was either full-time or part-time (working as a warehouseman and a journeyman electrician) depending on the volume of business. In July, 1960, he was in the warehouse on a full-time basis.

There were four electricians, considered to be key personnel, who had been with the firm up to 10 years. These men were paid on an hourly basis. However, if the work load was sufficiently reduced, they would be laid off.

In July, 1960, there were eight electricians, including four key men. Except for the preceding three years, normally 18 to 30 electricians were employed at this time of year.

ESTIMATING

Mr. Nance estimated about 90–95 percent of the jobs. Mr. Mills taught him how to estimate, but still reviewed the estimates and final sales price before they were submitted to the customer.

EXHIBIT 2

MR. NANCE'S SCHEDULE

7:30—Opened the offices and assigned manpower for day.
7:45—Issued instructions and dispatched workmen to jobs.
8:15—Ordered material for jobs from an electric supply firm.
8:25—Had phone call with workman wanting instructions.
8:30—Ordered materials for jobs from another firm.
8:45—Phoned union local regarding manpower.
9:05—Began estimate on a job.
9:30—Had conference and coffee with Mr. Mills.
10:00—Had conference with another workman regarding truck repairs.
10:15—Had phone call regarding insurance.
10:20—Had phone call with customer.
10:25—Continued conference regarding truck repairs.
10:30—Had conference with another workman regarding job.
10:40—Had phone call with customer.
10:45—Had phone call with another workman regarding job.
10:50—Had conference with another workman regarding job.
11:15—Had conference with supplier representative.
11:45—Continued estimate on a job.
12:30—Had phone call with customer.
12:45—Had phone call with electrical supply firm.
1:00—Had conference with another workman regarding job.
1:30—Had lunch.
2:00—Continued estimate on a job.
3:00—Had conference with another electric supply firm representative.
3:30—Continued estimate on a job.
4:00—Had conference with Mills on bid price on job (refer to estimate).
4:30—Checked with workmen on jobs completed or not completed.
4:45—Assigned manpower for following day.
5:10—Left work.

Labor

Wages were $3.90 an hour in July, 1960. However, in computing labor costs, the hourly rate was $4.40, which covered the direct wage, unemployment compensation insurance, and contributions to the electricians' pension fund.

On some jobs, there was a "walking" foreman who was considered to be nonproductive labor. For example, when six electricians were on a job, one was the foreman. Also, according to union rules, when there were 25 to 50 electricians, it was necessary to have two foremen. The foreman's hourly rate was 25 cents more than the journeyman rate.

Materials

The "Blue Book"[1] was used in estimating the material costs. For larger jobs (about $1,000), Reliable Company obtained special prices, thus lowering its costs. In the bid, the customer was given the benefit of these savings.

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[1] National Price Service—Contractors' Guide, Henderson-Hazel Corporation, Cleveland, Ohio. It suggests fair resale prices for electrical materials. The suggested

Markups

Mr. Nance stated that Reliable Company would like to recover the labor and materials costs plus 20 percent plus 10 percent on each job. For larger jobs, the preferable bid was labor and materials costs plus 15 percent plus 10 percent. However, the market was such in July, 1960, that the firm was unable to obtain many jobs with these markups.

Accuracy

Mr. Nance declared that their material costs were accurate, and their labor costs varied only slightly. He reviewed the completed jobs, determined the variations from the estimates, and the reasons for the differences.

From checking with other *competent* electrical contractors, Mr. Nance stated that their costs were approximately the same. He reiterated that they did not want to compete on a price basis but rather desired to remain in the quality end of the market. An illustration of an estimate and the follow-up check on actual costs is given in Exhibit 3.

Estimating for Residences

From a phone conversation with the customer, Mr. Nance attempted to determine whether the job was normal or abnormal. If abnormal, he went to the home to estimate it.

The installations done for electrical appliance dealers were computed on a standard price basis. When the electrician went to the home and determined that the job was normal, he performed the work. Otherwise, he informed the customer, who contacted Mr. Nance requesting an estimate.

Installation-Only Projects

As a rule, Reliable Company did not perform installation-only projects. Mr. Nance states: "We were dependent mainly on material for profit and to tie-up manpower on these projects was not as productive as on other projects. However, for important accounts, we did them for goodwill purposes."

Bidding

Mr. Mills questions whether bidding for jobs was antiquated. He thought that in a sellers' market, it was particularly effective, but not otherwise. He stated that some general contractors' practices regarding

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resale prices include contractors' current costs, overhead expense, and a fair profit (fair to the contractor and the customer).

An illustration of an item taken from the book is:

INWARD SCREW LUGS, SQUARE CORNER SWITCH BOXES "APPLETON"

Zone 2—Standard Package	Less than Standard	Resale Price (each)
$27.10 per 100	$33.90 per 100	$0.53

EXHIBIT 3*

4–11–55
Approximate Area 80,000 sq. ft.
Architect—Cal Atherton
Bid—Tuesday, April 12, 2:00 P.M.
Engineer—Bill Boyd

COMMERCIAL FACILITY
Price Recap

	Materials	*Labor*
Lighting fixtures	$ 908.08	$ 254.00
Lamps	117.49	24.20
Lighting equipment	186.80	238.60
Lighting conduit and wire	2,185.30	1,501.40
Service	649.31	144.60
Panels	441.00	59.00
Panel feeders	867.42	263.32
Total	$5,355.40	$2,485.12

1248 hours =
158 days =
31½ wk—1 man
1248
3.43 per hour
$4,280.64

Total materials	$ 5,355.40	
Total labor	4,280.64	
Total	$ 9,636.04	
2 percent sales tax	107.11	
Foreman Time 0.25 per hour	312.00	
Total	$10,155.15	
	1,523.25	(15%)
	$11,678.39	
	1,167.84	(10%)
	$12,846.23	

Bid $12,846.00
129.00 bond
$12,975.00 bid

Actual Cost

Materials	$5,596.12
Labor	2,976.70
	$8,572.82
2 percent tax	111.92
Total cost	$8,684.74

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* This exhibit refers to a competitive bidding job. It is unusual because of being completed so much faster than expected. One of Reliable Company's better electricians was the foreman. Also the firm obtained a beneficial change in material specifications.

bidding were vicious, but admitted that it took two parties (them and electrical contractors) to collude.

FINANCING

Terms of Trade

The vendors of Reliable Company required that all materials be paid, with certain discounts, within 10 days of the succeeding month after they were received. Reliable's customers remitted within 30 days, with no discount given, after the work was completed.

Practically all of the firm's sales were made on credit. Conditions in the industry—in dealing with architects and general contractors—were such that electrical contractors' collections were slow.

Cash Discounts

Until 1958, Mr. Nance stated that cash discounts on all materials were taken. "However, because we were in a financial bind later, we were unable to take them. We realized that we were losing quite a percentage because of borrowing money in addition to being unable to take the discounts."

Additional Financing

Mr. Mills obtained a personal loan for $20,000 from the Third National Bank in mid-June, 1960, and increased his equity in the firm.

ACCOUNTING

The invoicing was accomplished in Reliable Company's offices. One copy of the invoice, including the materials, labor, job expense, and tax, went to the accounting office of Mr. Roderick, who also served Mr. Peters.

Mr. Roderick's office also serviced three other electrical contractors' accounts. His office took care of the journal entries, ledgers, and tax and insurance reports. It attempted to send financial statements to Reliable Company each month. However, because of delays encountered in inventory-taking at the end of the firm's fiscal year, no statements were prepared for a few months.

Mr. Mills declared that he disliked the accounting end of the business. He did not consult with Mr. Roderick concerning Reliable's operations, not because of lack of confidence in the accountant's ability but rather because he conversed in subdued tones.

The following is an invoice submitted to Mr. Roderick's office:

EXHIBIT 4

RELIABLE COMPANY

815 North Louvre Phone GRand 8–9765
Tulsa, Oklahoma

Mrs. Searcy — 2925
Address — 6–28–60
Tulsa, Oklahoma

RE: APARTMENT AT ADDRESS____________________

Install wiring for 220V air conditioner.

Contract $67.00

M.	$19.62
Tax	0.39
I	2.25
S	26.40

EXHIBIT 5

Reliable Electric Company

Balance Sheets, 1949–59, Fiscal Year Ending November 30

Assets	*1949*	*1950*	*1951*	*1952*	*1953*	*1954*	*1955*	*1956*	*1957*	*1958*	*1959*
Current assets											
Cash	833	82	11,443	7,267	11,086	100	2,595	1,080	442	89	1,135
Accounts receivable	10,602	9,598	19,080	28,742	34,984	39,798	50,472	12,788	33,223	13,567	22,650
Notes receivable								8,601	6,284	3,714	2,500
Notes receivable—R. Mills								22,985	23,033	20,633	17,057
W. Nance, special account									131		
Employee advances										10	10
Material inventories	8,813	19,175	82,483	79,982	78,251	98,581	103,428	14,788	55,361	14,536	13,234
Work in process inventories								29,324	11,968	31,063	1,302
Prepaid expenses						2,642		1,410	1,812	1,674	1,572
Total	20,248	28,855	113,006	115,991	124,321	141,121	156,495	90,976	132,254	85,286	59,460
Liabilities and Net Worth											
Current liabilities											
Accounts payable	2,229	6,278	10,955	7,480	7,641	48,008	40,690	17,057	14,080	9,195	22,682
Notes payable	15,121	15,080	12,838	23,922	13,232	...	...	35,517	30,887	12,131	8,775
Notes payable—W. Nance								600	600	2,221	600
Taxes payable								1,708	3,247	2,156	2,475
Payments received on completion estimates			76,136	52,243	80,132	60,021	76,297	2,000	52,923	36,546	6,900
Accrued expenses	384	1,378	2,522	3,760	2,040	...	...	972	494	...	...
Total	17,734	22,736	102,451	87,456	103,045	108,029	116,987	57,854	102,231	62,249	41,432
Working capital	2,514	6,119	10,555	28,536	21,276	33,092	39,508	33,122	30,023	23,037	18,028
Fixed assets (depreciated)	6,857	5,385	9,005	12,771	10,553	7,106	5,835	7,383	7,213	7,059	5,325
Other assets	139	405	2,167	1,647	2,061	...	2,253	170	170	170	215
Net assets	9,510	11,909	21,727	42,954	33,890	40,198	47,596	40,675	37,406	30,266	23,568
Net worth											
Capital accounts											
Balance	9,510	9,510	11,909	21,727	42,954	33,888	40,196	47,596	40,675	37,406	30,266
Add: Net income		7,130	16,032	37,157	21,634	20,542	10,637	1,806	662	3,059	2,317
Deduct: Drawings for year		4,731	6,214	15,930	30,700	14,234	3,237	8,727	3,931	10,199	9,015
Total Net Worth	9,510	11,909	21,727	42,954	33,888	40,196	47,596	40,675	37,406	30,266	23,568

EXHIBIT 6

Reliable Electric Company
Income Statements, 1949–59, Fiscal Year Ending November 30

	1949	*1950*	*1951*	*1952*	*1953*	*1954*	*1955*	*1956*	*1957*	*1958*	*1959*
Net sales	$69,136	$105,715	$171,198	$245,039	$227,132	$239,490	$228,399	$209,837	$235,581	$205,658	$166,087
Cost of sales											
Inventories, beginning		8,812	19,175	82,483	79,982	78,251	98,580	103,428	44,111	67,330	45,599
Purchases	29,693	47,109	112,241	87,513	74,426	107,259	102,145	56,305	123,196	43,724	43,710
Labor	22,253	36,486	66,847	66,260	71,372	79,105	62,410	36,237	69,118	69,970	37,689
Other job and labor expenses	5,144	5,759	8,843	9,530	9,923	9,629	15,353	12,347	24,245	16,901	6,627
Less: Ending inventories	8,812	19,175	82,483	79,982	78,251	98,581	103,428	44,111	67,330	45,599	14,536
Total cost of goods sold	48,277	78,991	124,623	165,804	157,452	175,663	175,064	164,206	193,340	152,326	119,090
Gross profits on sales	20,859	26,724	46,575	79,235	69,680	63,827	53,339	45,631	42,241	53,332	46,996
Other income											
Discounts earned	222	966	2,420	1,709	1,705	2,161	1,422	1,200	1,525	121	33
Income from bad debts	...	119	...	17	...	..	405	...	...	207	120
Miscellaneous	780	660	...	...	113	...	...	18	55	22	...
Total income	21,861	28,469	48,995	80,961	71,498	65,988	55,166	46,849	43,821	53,682	47,149
Expenses											
Shop labor and expenses	284	523	2,065	1,486	2,241	1,456	832	11,642	12,093	6,670	3,675
Office salaries	5,555	8,258	9,833	13,861	16,275	17,842	10,773	2,660	3,141	3,320	3,902

Rent	2,200	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,950
Office expenses and supplies	651	1,022	720	508	973	807	414	726	801	619	727
Utilities	353	426	540	589	483	472	452	581	573	695	716
Telephone and telegraph	760	1,015	1,065	960	1,217	1,519	1,325	879	853	896	970
Estimating expenses	...	...	...	...	...	...	...	...	...	1,879	1,500
Advertising	521	966	1,508	3,060	6,744	1,210	1,276	2,238	2,213	2,462	2,850
Travel and entertainment	...	242	3,898	8,882	3,026	3,656	3,694	3,020	1,513	1,006	787
Legal and accounting	350	851	1,458	2,358	1,890	1,949	2,251	1,800	1,867	1,806	1,800
Donations	...	...	...	...	...	...	...	286	196	177	459
Interest paid	192	475	1,265	1,121	1,328	1,729	1,780	1,903	1,521	1,510	912
Subscriptions and dues	97	185	279	526	518	409	347	405	496	476	530
Collection expenses	...	...	...	...	...	...	...	58	24	1,841	71
Insurance	322	602	944	1,040	1,657	1,563	1,113	1,047	974	979	964
Taxes	95	249	251	342	461	476	505	608	358	477	847
Depreciation	1,177	1,472	2,141	2,802	3,699	3,675	3,465	2,058	1,855	2,383	1,736
Bad debts	377	293	1,294	994	2,999	2,133	607	402	279	1,361	...
Repair and maintenance	...	...	...	...	...	...	...	91	297	288	...
Other expenses	435	476	823	670	467	453	526	681	357	589	785
Total expenses	15,116	21,339	32,963	43,804	49,864	45,446	44,529	45,043	43,159	50,623	44,832
Net income (or net loss)	6,944	7,130	16,032	37,157	21,634	20,542	10,637	1,806	662	3,059	2,317

EXHIBIT 7

RELIABLE ELECTRIC COMPANY
Income Statement, First Half 1960 (In Dollars)

Net sales	$ 75,179
Cost of sales	
Inventories, beginning	14,536
Purchases	47,364
Labor	20,336
Other job and labor expense	6,866
Less: Ending inventories	33,080
Total cost of goods sold	56,022
Gross profits on sales	19,157
Other income	
Discounts earned	35
Income from bad debts	...
Miscellaneous	...
Total income	19,192
Expenses	
Shop labor and expense	339
Office salaries	1,755
Partners' salaries	8,008
Auto and truck expenses	2,556
Rent	1,500
Office expenses and supplies	584
Utilities	466
Telephone and telegraph	475
Estimating expenses	150
Advertising	1,622
Travel and entertainment	838
Legal and accounting	894
Donations	47
Interest paid	545
Subscriptions and dues	150
Collection expenses	...
Insurance	521
Taxes	666
Depreciation	832
Bad debts	...
Repair and maintenance	14
Other expenses	243
Total expenses	22,205
Net income (or net loss)	$(3,013)

Accounting Statements

Income statements and balance sheets for Reliable Company are presented for the years 1949–59 in Exhibits 5 and 6. Also, these statements for the first six months of 1960 are given in Exhibits 7 and 8.

In Exhibit 9, financial ratios for the electrical contracting industry are presented.

EXHIBIT 8

Reliable Electric Company
Balance Sheet as at May 31, 1960
(To the Nearest Dollar)

Assets

Current assets		
Cash	$ 950	
Accounts receivable	36,136	
Notes receivable	2,500	
Notes receivable—R. Mills	17,057	
Employee advances	10	
Material inventories	25,475	
Work in process inventories	7,605	
Prepaid expenses	1,967	
		$91,700

Fixed assets				
Depreciable assets				
	Cost	*Accumulated Depreciation*	*Net Value*	
Trucks and autos	$13,136	$9,838	$3,298	
Tools and equipment	1,369	1,071	297	
Office furniture and fixtures	2,746	1,850	896	
Total Depreciable Assets	17,251	12,759	4,492	
Total fixed assets				4,492
Other assets				
Deposits				215
Total Assets				$96,407

Liabilities and Net Worth

Current liabilities		
Accounts payable	$53,062	
Notes payable	18,709	
Notes payable—W. Nance	915	
Taxes payable	2,980	
Payments received on completed estimates	900	
		$76,566

Net worth:				
Capital accounts	R. Mills	W. Nance	Total	
Balance, December 1, 1959	$17,978	$5,588	$23,566	
Deduct: Net loss	2,711	301	3,012	
	15,267	5,287	20,554	
Deduct: Drawings	713		713	
Totals	14,554	5,287	19,841	
Net Worth				19,841
Total Liabilities				$96,407

Hummel Maid, Inc.[*]

In 1925, Mrs. Lucile Hummel moved into a new house and busied herself in making it into a home. It was located in a campus community. There was no dining room rug, but there were several football jerseys of rich gold and brown colors. With characteristic ingenuity, she converted the jerseys into a beautiful floor covering.

Many people admired the braided rug and several wanted to know how it was made. Mrs. Hummel—Lu to friends—helped many of them, and even casual acquaintances, make rugs for their own homes. The braided rugs were handsome and inexpensive if self-made. As more and more women insisted in trying to acquire the skill, it became evident that most failures were due to the use of ill-suited materials. Soon Lu Hummel was in business selling wool to the homemakers. A colored maid cut the wool into strips by hand in the basement.

Her hobby-business was interrupted for a span of years while she completed her education and became a professional teacher. She managed her bachelor's and master's degrees and was well on her way to the doctor's with only her dissertation unfinished when World War II interrupted her education by sending her husband into the Southwest. She found a teaching position at The University of Tulsa and soon became the head of the office administration department. She was an enthusiastic, understanding, patient teacher, admired by her students and fellow professors. Her husband returned after the war and both seemed destined to have separate professional careers, she as a professor and he as an oil company executive.

Even while teaching, she kept alive her interest in hand-braided rugs by making and supervising their making in her spare time. But again, her career was interrupted when the oil company decentralized and her husband was transferred to Oklahoma City. In her new home, she reassembled her interests and planned again for her future. She considered an offer to teach at a nearby state university and decided not to accept. This was her opportunity to revive her rug business.

Wherever she traveled for a period of 25 years, she looked for rugs of this type. She found them in such places as the show cases at the Smithsonian Institute, the national shrines of historical Americans, and the old homes of colonial origin. She read all available materials written about braided rugs, and she collected hundreds of pictures showing them used with furniture of all periods.

Her interest was rekindled when she met one of her early customers, the president of a large transcontinental trucking company. He was convinced that if she could make rugs like he had purchased years ago, she could make an excellent profit. He offered to invest $50,000 and have more available if the profit prospects warranted.

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[*] Prepared by M. M. Hargrove, The University of Tulsa.

With free time on her hands and the old enthusiasm bubbling again, Lu Hummel consulted her banker and a lawyer recommended by a friend. The banker suggested, "We'll get you some money," and the attorney added, "Let's make a big thing of this." Feeding her high spirits on these bits of professional advice, Lu Hummel continued to consider the aspects of her proposed business. Gradually, her new thoughts crystalized. She found 20 women willing to buy $20,000 of stock. She incorporated under the name of Hummel Maid, Inc., in 1950, with common stock totaling $50,000. The women all wanted to help. Fifteen agreed to serve as members of the board of directors. Generally, they were well known and held responsible positions in the major companies of the city. Lu Hummel retained 52 percent of the stock.

LOCATION

At an early meeting of the members of the board of directors, and after they had voted themselves a salary of $10 per meeting, the women considered the problem of finding a good location for Hummel Maid, Inc. One suggested location was on the eastern edge of the city. Lu thought that incoming travelers emerging from the high speed traffic of the Turner Turnpike would want to stop and relax before tackling the traffic of the city by-passes and congested throughways. Or, if traveling toward the east, the drivers would want to stop before entering the turnpike gates for relaxation, cheaper gas and oil, or to get a bite to eat. Near the proposed site, three large service stations cared for the needs of the cars. A beautiful new unit of a large chain of motels was across the divided highway. These businesses were obviously doing a large volume of trade. There was talk at the conference tables and business clubs that a tourist attraction, Frontier City, was to be located nearby. Here the restless children and fatigued adults would be invited to watch snatches of the life of the old West enacted with exciting realism. Also, tourists were invited to visit the modern, attractive training school of one of the nation's largest automobile manufacturers.

The directors decided to locate in this vicinity. A contact was made with Mr. A. C. Brown, part-owner and operator of the motel. Mr. Brown owned land along the highway and offered to sell for $100 a front foot. The lots were 300 feet deep. For the site chosen with 100 front feet, he wanted $10,000 and would hold the deal open for $100 earnest money down. After practically no discussion, the directors accepted Mr. Brown's offer and called for $10,000 on unpaid stock to cover the purchase cost.

An attractive building was erected well back on the site so as to allow for parking. The building served as a retail display room, home office, training center for workers, and shipping center. The original cost of the building was $27,500. Its pleasing appearance conveyed the image of the braided rug business residing therein. Furnishings were purchased to enhance the rug merchandise to be displayed. These appointments eventually cost $10,000. A loan was secured on the real property calling for an annual payment of $2,000 plus interest.

There were many other necessary items. An appropriate sign was acquired. Insurance coverage was provided. Taxes and utilities bills were submitted and seemed high when related to the income of the infant business. Then more help and more inventories were needed, and it appeared obvious that the anticipated increased production must soon get under way.

PROPOSED OPERATIONS

Lu Hummel outlined her proposed operations to her board members. Production would not be done by factory methods. The work would be done in the worker's home. In this way, there would be less capital invested and the operating costs would be minimized. The workers would be recruited from the housewives and unemployed women of the community who would work their spare time. Lu Hummel would teach them how to make the rugs. Excellent designs and beautiful woolen materials would be supplied to the workers. Hummel Maid, Inc., would market the rugs for the workers. It would advertise and promote the sales. The board of directors approved the program as outlined.

TRAINING

In arranging the teaching room, Lu Hummel used the vestibule school idea, and in this way introduced her workers to the ideals of the good home workshop. At first the lessons were free to all comers, but a $10 charge was made after many women learned the art only to quit after making a single rug. The $10 was returned after three months if the worker had a good production record. The learners met at 9:30 each Friday morning. These group meetings started with a 20-minute lecture advising the workers what was expected of them, the time they should take to produce a rug, the size and layout of the ideal production room, the size of the work table, what treatment would help if they were affected by wool and dust allergies, the transportation procedures, the problems caused by small children being around the work center, and similar items of information.

After the lecture, the workers were taught how to make small circular rugs. They developed the skill of the proper use of the thumb, which was the key to successful rug making, and proper stitching which made the rugs lie flat. The necessary time was given for each learner to become expert. Lu Hummel believed she could tell after the worker made her first rug if she would succeed. After the small circular rugs, the workers were advanced to the more difficult assignment of the oval rugs. After the third lesson, the workers were introduced to the patterned rugs.

WORKERS

For the most part, the workers took unusual pride in their work. They were able to fit their rug work into their family work schedules. Generally, the farm women were better producers than the suburban women. The farm women had fewer distractions. They could schedule their work to miss the peaks of cotton picking, strawberry processing, and vegetable canning. Age of the workers had little to do with the quality and quantity of production. Some young mothers with small children were slow in getting the rugs produced while others did fast work of acceptable quality. Often several workers were in one family group; and one such group included a mother and her two daughters, an aunt and her two daughters, and a grandmother. No special physical attributes were needed, but outside interests did interfere. Many women felt a sense of accomplishment from creating a beautiful and useful product, but all agreed that the money they made was their prime motivator. A few of the women had anticipated their incomes and had made purchases on installment contracts for home appliances. However, many women received more than just money from their work. They felt a reward in creating a handsome, useful product. One woman inherited a substantial estate and continued to maintain her production schedule. Another worker, almost 90, sold her land to the federal government since it was to be inundated by the waters of a flood control dam. With plenty of money to care for her and being too old to make the heavy, big rugs, she continued to make "mockups" which were sold to dealers.

Many of the women had converted a milk house, shed, or spare room into a work room. In these varied facilities the Hummel Maid rugs were made entirely by hand by the women who were trained and supervised personally by Lu Hummel. A distinctive cloth label was signed by the woman who made the rug and attached to the rug. The label stated that this was an original heirloom rug designed by Lu Hummel, hand braided for the designated customer, the handiwork of the designated worker, specifying the pattern and size, and recording the register number. The pattern was registered by number so that in the years to come the customer could duplicate the order if he so desired.

PRODUCTION

In production, the wool strips were braided first and then sewed by hand with a special concealed stitch. For sewing thread, a heavy grade of waxed linen warp was used. The rugs were heavy, weighing about one pound for each square foot. A 9 x 12 foot rug weighed approximately 100 pounds.

More than a hundred color shades were available and all were vat dyed. If the right color for the customer's decoration scheme was not on hand, a special dye lot was run for a small charge which was never over 10 dollars. Colors were not guaranteed against fading. Even automobile finishes, upholstery materials, wallpaper, and paints fade. Every precaution, however, was taken to get a good dye job done.

The standard designs called for circle or oval shapes. Special shapes included rectangular, square, three-circle, multicircle, and half-circle and were available at higher cost. The customer was asked to provide the color scheme desired. While standard color patterns were ordered by name, custom color patterns were available at no extra charge. Even the standard color patterns could be altered to meet customers' needs and without extra charge. For example, if a buyer wanted Cape Cod No. 23, yellows and browns, but wanted a touch of green and a tan border, it was produced. Lu Hummel worked out the color changes and sent the design to the customer for approval.

Five easy steps to help the customer in ordering included (1) size; (2) shape; (3) general effect including light, dark, predominating color, and accent colors, and when possible the customer was asked to send swatches of furniture fabric or wallpaper; (4) select standard patterns wanted from colored pictures; (5) price. After the order was received, a chart was submitted to the customer with colors attached showing what was to be used in each row. When the chart was approved, production on the rug was scheduled and started. If the customer wanted changes in the chart submitted, the revised chart was re-sent for approval.

The office work connected with each order was no simple task. Acknowledgment of the order was mailed, the shipping date was scheduled, the design of the rug planned and approved, often many letters written to be certain that the customer was satisfied, rug charts were kept, labels recorded, wool poundages estimated for each color, and the colors selected for the rug were dyed in proper quantities.

And, good records were kept. Lu Hummel once remarked, "Cost accounting is a must. We simply have to know where we stand with out costs." She recalled a competitor who bought a large quantity of wool from a bankrupt company at 10 cents a pound which usually cost 50 cents. He priced his rugs on this low cost of wool and, upon depleting his low-cost inventory, had to increase prices substantially and lost many of his best distributors.

Lu had learned that she had to be certain about all of her costs of operating, especially before she hit a new market. If her cost records were inaccurate, she made decisions from false information. She knew the close relationship between cost and sales prices. When sales prices were increased she had to have justification for herself, her dealers, and her customers. As a policy, she tried never to raise all prices at the same time and to have as few increases as possible. She had found that she could raise prices on odd sizes and shapes with little or no objection. She anticipated that prices would need to be raised on the regular line in the near future, but she pointed out that there had been no increase necessary for four years.

PRODUCTION PROBLEMS

To avoid confusion, workers were asked to notify the office at least three days before they returned a finished rug so that the next rug could be readied. The workers were scheduled so that not more than two were in the shop at the same time, to keep from wasting time for the workers and the office staff. The new workers who still needed to be checked and perhaps retrained on certain phases were scheduled singly.

The workers were given the following suggestions to help assure efficiency in the shop when they called:

1. Since the colors are separated anyhow, tie each color to make it easier to be put up.
2. Bring sacks of unused wool into the large teaching room for weighing and be sure your name is on the sack.
3. Take small rugs to back shipping rooms and large rugs to front.
4. Keep your small scraps in a paper sack and your short lengths of 1 to 2 feet in another sack so we can put it in our hit-and-miss barrels. Those scraps have value!
5. Check in the office to get the materials for the rug inspector to use.
6. While your rug is being inspected, put your colors on the chart for your next rug.
7. The inspector will talk to you privately about the rug and help you with any problems.
8. Take your check sheet and materials from the finished rug to the office and sign your slip.
9. Now get checked out with wool, charts, and supplies for the new rug.
10. Place the due date on your chart. If you feel you can't make it, tell us now! If something comes up later while you are at work on the rug, tell us in time to have someone else take over.

Within a couple of years, after moving into the new building, sales poured in and production was increased repeatedly. A group of nearly 100 women workers were trained and producing. More workers were needed, and Lu Hummel appealed to trained producers to help find the right type of women. She explained that they could not use a producer who, after she had learned to make small rugs, could not make a 9 x 12 size and over. And with so many workers, the money invested in wool increased so substantially that some control was necessary. Lu Hummel decreed that only one half of the wool needed for a large rug would be issued initially, and the remainder issued only when needed. All the wool needed on any rug up to size 6 x 9 was issued with the work order. When it became apparent that special dye problems would delay the production, Lu Hummel gave to the braider a "no rush" order on which she was to work if her production should be stopped.

When an order was received for a set of rugs, it was produced by one person. It was found easier to give the total order to one woman and, when produced, the rugs were all alike. If the order for a set of rugs involved unusually large rugs, it was given to two women who lived close together for joint production.

Lu Hummel knew the answers to the problems brought to her. She showed the women how to make a firm even braid necessary for a beautiful rug. A tight braid was difficult to sew and not handsome. She demonstrated how to braid different weights of wool together. She determined that every row put on a rug should add two inches to the size. With this standardization, production control and uniform quality were possible. Through experience, she found that there were several techniques for improving the color beauty. For example, when it was necessary to change shades, it was best done in the corners.

A score card was kept from each of the "rugged braiders." A perfect score was 300 points. The rating points were as follows:

	Possible Points	*Points Earned*
Braiding:		
Firm	30	______
Even	10	______
Joinings do not show	10	______
Colors joined at proper place	10	______
Sewing:		
Firm	30	______
Stitches hidden	10	______
Center:		
Straight	20	______
Correct length	20	______
Ending:		
Tapered properly	10	______
Sewed firm	10	______
Label:		
Sewed in right place and signed	10	______
Last three rows:		
Trimmed and sewed right	20	______
General appearance:		
Chart followed	20	______
Clipped on top and bottom	10	______
Lies flat	20	______
Size correct	30	______
In on time	30	______
Total points	300	______

General comments by inspector:
Signed: ______________________________, Inspector

Lu Hummel recalled vividly the crisis precipitated by the regional head of the Wage and Hour Administration. Hummel Maid, Inc., had been reported to the Administration by an unknown informer. A heated discussion ensued about the relationship of the braiders to the company. Lu claimed that the women were independent contractors and that she had no control over their hours of work or their production schedules. She gave the agent 24 names of her braiders with the request that he visit their work centers and learn first hand about this relationship. From his inspection, he determined and recommended that the braiders were, de facto, contractors and, as such, could certainly make $1.00 or more per hour. His ruling that they were independent contractors simplified Lu's relationships with them and with the government.

If an adverse recommendation had been made by the agent, Hummel Maid, Inc., would have had to hire more accounting services, paid more taxes, and incurred more office expenses. Actually, the company had operated one year under social security. This was discontinued. All contractors signed the contract shown in Exhibit 1 (see page 588).

The better braiders made substantial, supplementary incomes for their families. They averaged $1,200–$1,500 per year. One woman made in excess of $4,000 annually, and another had built a $10,000 home from her rug money. Many had added rooms and improvements to their homes or modernized their appliances.

FINANCES

The original five-year loan had to be refinanced. The loan holder died in April and the loan was due the following September. When the lender's estate was probated, it showed that the loan had been paid down to $19,000. The Southwestern Life Insurance Company was asked for a loan. The company would not deal with a group of women. However, the company did offer to make a personal loan to Lu Hummel. Lu owned 52 percent of the stock at the date of organization, and four years later she had increased her share of ownership to 83 percent of the 351 shares outstanding. Ocasionally, differences of opinions occurred. On one such occasion, Lu had to pay almost double per share to get a few directors out of the company. This price was substantially over the book value of the stock. After a series of attempted negotiations, Lu acquired the land and building on her personal credit and Hummel Maid, Inc., paid her rent for their use.

MARKETING THE RUGS

At first, all the rugs that could be produced were sold without much effort. One satisfied customer told another and this word-of-mouth advertising absorbed the limited production. Since the rugs were made of

EXHIBIT 1

CONTRACT

This Agreement, made and entered into this ________ day of ________, 19__, by and between Hummel Maid, Inc., a corporation, hereinafter referred to as First Party, and ____________________, an individual, hereinafter referred to as Second Party, WITNESSETH:

WHEREAS, Second Party desires to make, assemble, and manufacture or otherwise produce, braided and woven rugs, carpets, mats, and similar products at the instance and request of First Party on a piece work basis as an independent contractor; and

WHEREAS, Second Party is to be paid for such piece work on a square footage basis mutually agreed upon from time to time;

NOW, THEREFORE, IN CONSIDERATION OF the sum of One Dollar ($1.00), the receipt of which is hereby acknowledged by Second Party, and of the mutual covenants and agreements hereinafter contained, it is agreed as follows:

1. Second Party is to make, assemble, manufacture, or otherwise produce, braided and woven rugs, carpets, mats and similar products for First Party at its instance and request, and in so doing Second Party is to perform such work at her home or any other place except at the office or on the premises of First Party.

2. Second Party's hours of labor shall be discretionary and her sole responsibility, so long as the product is completed within a reasonable time after the order is placed by First Party.

3. Second Party shall be responsible to First Party as to result of work only, and shall not be controlled in detail respecting method of accomplishment other than general method so that the finished product shall be of the standard required by First Party.

4. Second Party shall have the right to be engaged in any other business or undertaking, so long as it does not interfere with Second Party's performance within a reasonable time of work ordered by First Party, and so long as the other business or undertaking is not competitive with the business of the First Party.

5. Second Party further especially covenants and agrees that during the time contract work is done for First Party, and for a period of five (5) years thereafter, Second Party, either for herself, or in behalf of any other person, firm, or corporation, will not disclose to any person whatsoever, or use or employ, any of the methods, processes, secrets, or other knowledge and information, employed, learned or obtained in connection with the business of First Party, said Second Party especially admitting, recognizing and acknowledging that for the proper protection of the business of First Party it is absolutely necessary and essential that all matters connected with and arising out of or pertaining to First Party's business and its methods, processes, and secrets be kept absolutely confidential at all times during the contractual relationship of the parties hereto and for five (5) years thereafter.

6. This agreement shall be binding upon the parties hereto, their heirs, executors, administrators, successors and assigns.

Executed the day and year first above written.

HUMMEL MAID, INC.

By ____________________________

President
First Party

____

Second Party

heavy wool, thickly braided, and lasted almost a lifetime with reasonable care, there was little repeat business. Owners of large homes frequently wanted additional rugs for other rooms and occasionally wanted matching sets.

Lu Hummel was astounded at the free publicity her rugs received in *House Beautiful, Better Homes and Gardens, Interior Design, Wall Street Journal,* and many other publications. She managed a modest advertising program run in different home magazines which she considered helpful in selling the rugs. The chatty, friendly, informative letters sent to prospective and regular dealers were effective. The prospects were urged to invest in a sales kit and stock-rugs which, when purchased, entitled them to be listed as official dealers. Kit No. 1 cost $10.00 and included an attractive sales book with colored pictures, color swatches, a sample of workmanship, and sales helps. Kit No. 2, $15.00, included all materials in No. 1 and had also five pre-shaped mockups of the most popular patterns. The kits were sold to the dealers at less than one half of the actual cost because experience had shown how much a sales staff needed this information and aids in order to present the line. A 30 x 48 inch size stock rug made the sales efforts even more effective, and a few of the best dealers, who had the floor space, bought sizes ranging from 9 x 12 foot down for display.

The themes repeated frequently in the dealer contacts were (1) your profit for each sale is much greater on our rugs; (2) the customer knows the rug was made for her, and when pleased, she becomes an active sales force for your store; and(3) the rugs are so right for the casual living of today. On the special price lists prepared for dealers, the prices were at retail and the dealer's discount was 40 percent.

The number of dealers increased until there were more than 500 department and furniture stores, carpet shops, and decorators all over the country including New England, the home of the braided rug. With this expanded sales organization, it was difficult to keep a production-sales balance. Lu recognized the growing pains. Her beloved Hummel Maid rugs sold too well! What should have been a sweet experience proved to be a major problem of production. Her workers were unable to speed up so she tried to turn the operation into factory-type production. This didn't work because she couldn't get the type of worker who would take pride in her work. Delivery dates were delayed. Lu philosophized, "You do know that the people of Oklahoma talk slowly, and they work the same way; but the beauty of the finished product is well worth the time." After returning to home-type production, she appealed to her dealers to help her keep her high standards of quality and to be understanding if deliveries were slow. Lu explained that if the homemaker had wanted a machine-made braided rug with limitations as to colors and with no special designing and a sterotype look, she would not have ordered a Hummel Maid quality rug.

MARKETING CHANNELS TRIED

Hummel Maid, Inc., had tried many channels of distribution. Word-of-mouth advertising was sufficient during the early years to move all of the rugs produced. As production mounted, an attempt was made to combine the normal retail business with some wholesale activities. This program was gradually replaced by exclusive distributors. It was hoped that these distributors would develop their exclusive territories and would push the rugs more diligently than the wholesalers who often carried them as a relatively small sideline. The dealers provided all customer services and billed their own accounts. Hummel Maid, Inc., was the supplier with little customer contact under this arrangement. When the sales of the exclusive distributors were disappointing, the company attempted to operate as a wholesaler doing a mail order business. Later, sales representatives replaced the mail order program. These sales representatives emphasized the wholesale business and did only casual retail business. They worked for Hummel Maid, Inc., under nation-wide policies. They tried to get stores with good showrooms as customers. For example, the rugs were displayed in the showroom of Sullivan's on Fifth Avenue, New York City, and in the showroom of the Trade Mart in Dallas, Texas. The sales representatives were paid 10 percent commission which was considered good by the trades people.

MARSHALL FIELD OF CHICAGO

When Lu was starting her rug business and had little experience in production and distribution, she visited Chicago and called on the buyers for Marshall Field. She explained her ideas for her rug business to an attentive professional buyer. He vacillated between enthusiasm and restraint. Finally, he advised, "As soon as you get 30 women working, come back." And, 30 years later, Lu was back, and the store became a distributor for her.

One day, Lu received a long-distance call from an executive of Marshall Field. He told her, "Lu, you're ruining your business with this distributor who calls on us. Get rid of him, and I'll help you get better distributors." She let the distributor go, and the executive gave liberally of his time to help find better men to represent Hummel Maid, Inc.

ADMINISTRATIVE PERSONNEL

Mrs. Elsie Shidell, the office manager, started with Hummel Maid, Inc., two years ago. She learned to design some of the rugs and worked with the independent contractors when needed. She assumed much of the routine work processing orders, invoicing, preparing materials, keeping

EXHIBIT 2

HUMMEL MAID, INC.
Balance Sheet
1954–1962

	1954–55		*1955–56*		*1956–57*		*1957–58*		*1958–59*		*1959–60*		*1960–61*		*1961–62*	
Current assets	35,547		23,425		32,462		29,606		31,324		30,267		27,173		31,944	
Fixed assets	2,500		58,376		61,027		58,545		56,144		53,824		32,561		33,840	
Other assets	38,500		36,652		40,852		40,852		40,852		40,852		40,852		40,852	
Total		76,547		118,453		134,341		129,003		128,320		124,943		100,586		106,636
Current liabilities	4,739		8,908		6,691		3,765		4,115		2,415		7,364		16,607	
Long-term liabilities	...		34,300		31,500		28,700		25,900		25,900		...		...	
Total		4,739		43,208		38,191		32,465		30,015		28,315		7,364		16,607
Net worth		71,808		75,245		96,150		96,538		98,305		96,628		93,222		90,029
Income and Expense Items																
Sales	46,791		85,957		107,995		95,749		102,196		91,256		97,861		99,382	
Gross profit	27,128		41,075		57,429		47,953		49,206		40,238		45,147		41,086	
Expenses	24,289		37,638		36,524		47,565		47,439		41,915		48,553		44,279	
Net profit and loss after taxes	2,839		3,437		20,905		388		1,767		(1,667)		(3,406)		(3,193)	
Sales Volume																
Retail	40,580		71,400		81,395		60,345		52,503		23,881		25,501		16,792	
Wholesale	6,211		14,557		26,600		35,404		49,693		67,375		72,360		82,590	

records on the workers, and the general office work. Her husband worked for an oil field equipment firm. Her 29-year-old son was married and had two children. Mrs. Shidell had worked for 12 years in a retail grocery owned jointly with her husband. Prior to the grocery venture, she had spent five years as office manager of a tool company and three years as a partner in a small company selling oil field equipment. She had had a little experience in selling in a retail gift shop.

Charles Irvin Springer, Jr., son of Lu Hummel, was 30 and married. He had completed three and one-half years of college work in business administration. During his college years, he had worked closely with Lu, helping especially with the cutting of the wool and supervising the rug makers. For several years he had created authoritative hand-made stage coaches for dude ranchers, movie producers, and other customers. Recently he had been giving his full time to the rug business. He was mechanically inclined and creative.

LU HUMMEL

Lu Hummel drove herself hard in all that she did. Her enthusiasm and optimism were contagious. She liked people, obviously, and they responded. About six months ago, she had a siege with the flu. She had a continuous cold and knew she was run down. Her hands and feet became swollen and painful. When they turned red and became of major concern, and relief from pain was only temporary, her family physician, Dr. R. L. Stone, referred her to Dr. H. C. Johnson, chief of staff of the large, new Baptist Hospital.

One morning at breakfast time, Charles Springer called Elsie Shidell and said, "Dr. Johnson has told mother she has Raynaud's disease and that she will be a convalescent for an indefinite period of time. She doesn't know when, if ever, she can return to the job. Raynaud's disease is not fatal, but she is unable to use her hands, and her feet are affected. She must be unusually careful because in her exhausted condition she has little resistance to infectious and other diseases."

Moore-Handley Hardware Company, Inc. (A)[*]

Company History

The Moore-Handley Hardware Company, Inc., began operations during February, 1882, in Birmingham, Alabama, as Moore, Moore, and Handley, a partnership with a capital investment of $1,500 and a one-story building containing approximately 1,500 square feet of floor space. Starting as machinery agents with Alabama as a territory, Moore, Moore, and Handley expanded rapidly into the wholesale and retail hardware business.

Success marked this venture from its very beginning and moves to more spacious quarters were made in 1883, 1884, and 1886 when a three-story building, especially designed for the wholesale and retail hardware and machinery trades, was constructed. Sales had soared to over $25,000 a month by this time, and the firm had become a heavy owner and operator of real estate in the business section of Birmingham.

In 1887, Moore, Moore, and Handley decided to specialize in wholesale hardware only and bought shelf hardware stock from Harry Jones, a Knoxville salesman, who came to work as the first hardware "drummer" for the company. It was this same individual who thought up the "America's Best" trademark which is still used by the company.

In 1888, the firm incorporated under the name of Moore and Handley Hardware Company with a capital stock of $100,000. By this time, annual sales had mounted to over $300,000 and goods were being shipped from the Birmingham warehouse by dummy lines to Pratt City, Ensley, East Lake, and Bessemer.

During the early 1900's, a Building Materials Department was added to the expanding company and within a few years the Warrior Machine Shop, producers of glazed sash, was acquired as the first manufacturing subsidiary of the company.

The company was reincorporated on January 30, 1909, under the name of Moore Handley Hardware Company with a capital stock of $500,000. At this time, the real estate holdings of the company were transferred to a separate organization known as the Moore and Handley Supply Company.

World War I temporarily slowed the expansion of the company. However, immediately following the war, there was such a growth in business that several new departments were added, and of necessity, warehouses were added to house the new lines. The advent of the hydroelectrical development in north Alabama brought about a definite need for a connection with one of the major electrical equipment manufacturers and Moore-Handley managed to be appointed as the Westinghouse Agent-Jobbers for the area. This was the beginning of the Electrical Department which, after the creation of the Tennessee Valley Authority in 1933, became a major contributor to the Moore-Handley success story.

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[*] Prepared by Frederic A. Brett, University of Alabama.

In 1924, the capital stock of the company was increased to $2,000,000 and a new building was constructed to house the expanding sash and door manufacturing plant. One year later, the authorized stock was increased to $2,500,000 and the Moore and Handley Supply Company was absorbed into the general structure.

Management's aggressiveness and flexibility combined with the prosperity of the 1920's resulted in phenomenal growth for the company which by 1932 boasted 650 employees, 10 buildings, 11 acres of floor space, 10 departments, and 70 salesmen who covered territories which extended over all of Alabama, Mississippi, western and southern Georgia, west Florida, and southern Tennessee.

The company continued to grow, at a decreased rate, during the depression years of the 1930's and the war years of the early 1940's. However, with the cessation of hostilities in 1945, business activity again gained momentum.

On November 1, 1946, the legal entity of the company was changed when the company sold practically all of its properties except real estate to a corporation which had been organized by the Union Securities Corporation of New York City and the Equitable Securities Corporation of Nashville. This new corporation was called Moore-Handley Hardware Company, Inc., and is the present company. A few months after the formation of the new corporation, Union and Equitable sold their interests to the public with a good portion of the stock being acquired by Moore-Handley employees.

During 1948, full-scale divisions were established in Nashville, Tennessee, and Mobile, Alabama. These divisions were fully equipped to render a complete wholesaling service to customers in these areas. A new plant was constructed in Nashville at a cost of $570,000 which provided 117,000 square feet of floor space with the most modern equipment for storage and handling of materials on a one-floor level. The Mobile Division was located in the former Gulf Atlantic Warehouse with a total floor space of 168,000 square feet which had been acquired for $250,000. Alterations and improvements costing approximately $65,000 were made to this strategically located property to adapt it to company needs. This location enabled Moore-Handley to assemble merchandise by water routes from east and west coast ports for storage and shipment through the rapidly growing Port of Mobile.

A third division was opened in Chattanooga, Tennessee, in March

1951, when Moore-Handley became a franchised distributor of the Coolerator line of refrigerators, ranges, freezers, and other electrical appliances. The following year, this division had to be enlarged to handle the growing business which had expanded to include the handling of Thor washers and Motorola radio and television products.

It was also in 1952 that a branch warehouse and terminal was established in Decatur, Alabama, to serve more efficiently the fast-growing Tennessee Valley area and to produce further freight and handling economies for both the company and its customers. This operation is the basis for the Case A discussion.

For several years prior to 1957, Moore-Handley had a working agreement with the Young Hardware Company, Inc., in Atlanta, Georgia, for the sale of Moore-Handley merchandise in that area. In May, 1957, this arrangement was terminated when Moore-Handley bought out the small inventory and took over the sales force of this company. The following January, Moore-Handley opened its own sales office in Atlanta but because of the development of the Morhaul delivery equipment (see "Decatur Operation" for an explanation of this equipment) no warehouse was needed. By using Morhaul equipment, customers in the Atlanta area could be serviced more efficiently and at reduced cost directly from the company's central warehouses in Birmingham.

Today, the Moore-Handley Hardware Company, Inc., is the second largest general-line, full-service, distributor of industrial hardware and supplies in the United States. This phenomenal growth record is evidenced by the financial records which show net sales exceeding $25 million for the first time in 1947; $30 million in 1950; $35 million in 1951; and $40 million in 1955 and every year since with the exception of 1958. Other comparative financial data are shown in Exhibit 1.

The Decatur Operation

The rapid industrialization of north Alabama during and immediately following World War II opened up a new area for the concentration of Moore-Handley salesmen. The principal industrial centers within this territory were the Tri-Cities area (Florence, Sheffield, and Tuscumbia), Decatur, and Huntsville. All of these points were between 100 and 140 miles from the nearest company warehouse in Birmingham. (Exhibit 2.)

Prior to 1952, the following procedure was used to service customers in the north Alabama area: (1) Orders would be given to salesmen or sent to the Birmingham office. (2) Orders received by salesmen in the field would be phoned or mailed to the Birmingham office where all orders were processed and scheduled for shipment from the Birmingham warehouse. (3) Shipments were made by common carrier or by company trucks from the Birmingham warehouse. This method of delivery was rather costly as it was economical to use company trucks only for relatively large orders. Small orders, a high percentage of which were

EXHIBIT 1

MOORE-HANDLEY HARDWARE COMPANY, INC.
Six-Year Comparative Financial Data
(Thousands of Dollars)

	1954	*1955*	*1956*	*1957*	*1958*	*1959*
Net sales	$37,081	$42,354	$42,272	$41,526	$36,494	$40,735
Net earnings	$ 538	$ 717	$ 711	$ 596	$ 579	$ 569
Dividends on preferred stock	65	64	62	51	43	13
Net earnings applicable to common stock	$ 473	$ 653	$ 649	$ 545	$ 536	$ 556
Dividends on common stock	156	208	313	313	234	313
Net earnings retained in business	$ 317	$ 445	$ 336	$ 232	$ 302	$ 243
Current assets	$11,065	$12,442	$12,474	$11,159	$12,614	$12,775
Current liabilities	4,158	5,072	4,845	3,655	4,561	4,700
Working capital	$ 6,907	$ 7,370	$ 7,629	$ 7,504	$ 8,053	$ 8,075
Property, fixtures, equipment	1,081	1,027	952	940	837	838
Other assets	240	116	91	83	111	110
	$ 8,228	$ 8,513	$ 8,672	$ 8,527	$ 9,001	$ 9,023
Long-term debt	375	250	125	...	850	700
Net assets	$ 7,853	$ 8,263	$ 8,547	$ 8,527	$ 8,151	$ 8,323
Preferred stock	1,307	1,273	1,221	969	291	219
Book value of common stock	$ 6,546	$ 6,990	$ 7,326	$ 7,558	$ 7,860	$ 8,104
Common stock earnings per share	$ 0.91	$ 1.25	$ 1.25	$ 1.05	$ 1.03	$ 1.07
Dividends paid per share—Common	0.45	0.40	0.60	0.60	0.45	0.60

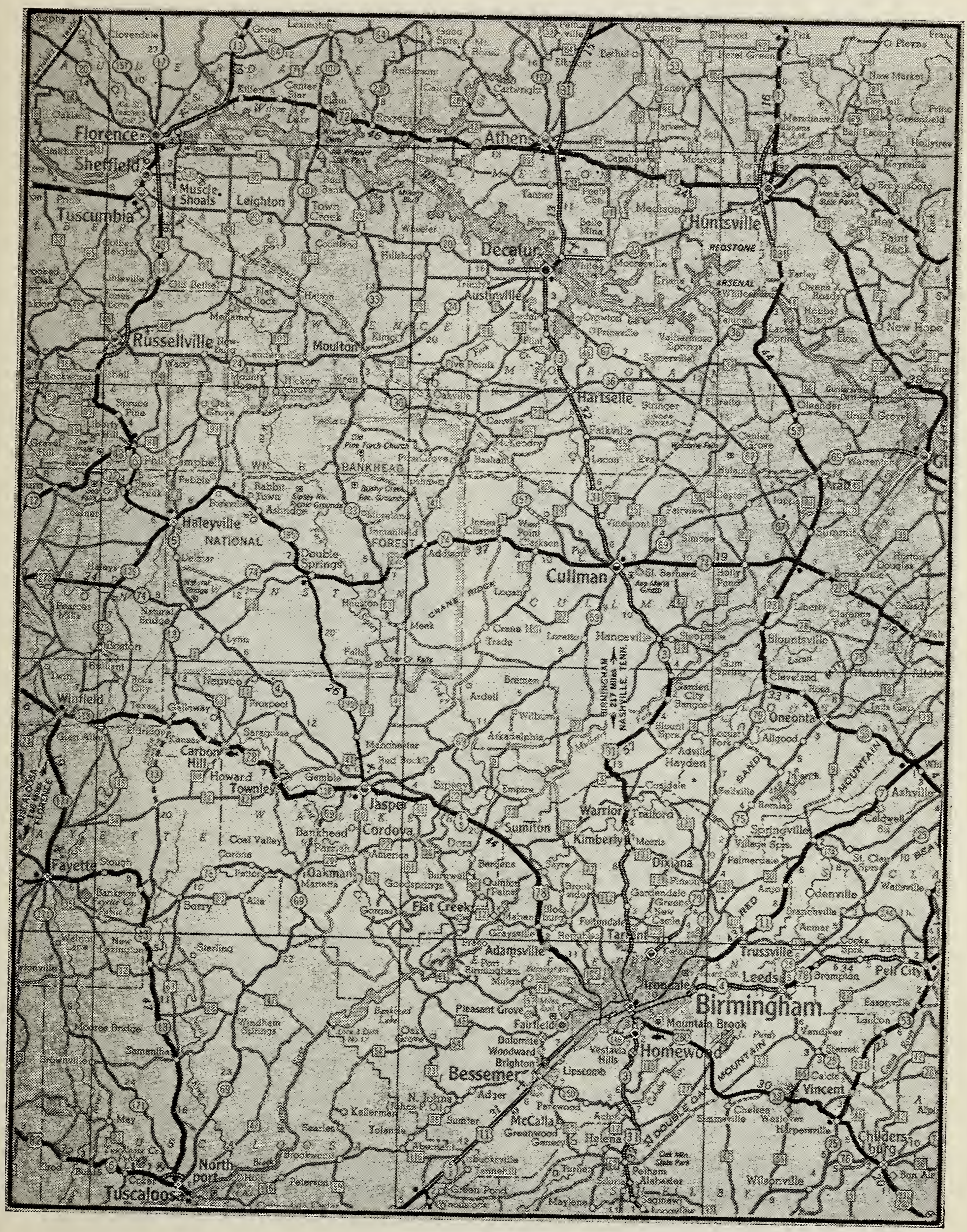
subject to a minimum rate charge, were shipped by common carrier.

As business volume increased in this area, it became evident that this delivery procedure was not satisfactory from a customer service or cost point of view. Competition in the industrial distribution field appears to be based on quality, service, and price. From its beginning, Moore-Handley had committed itself to the basic business philosophy of handling only quality products. Thus, management concentrated on improving customer service while maintaining a price structure compatible with the functions performed. As prices are highly competitive in this field, management was faced with the problem of increasing customer service at a reduced cost. The opening of the Nashville Division in 1948 further complicated the transportation problems in this area as a high percentage of the stock carried in the Nashville warehouse had to be shipped from the Birmingham warehouse.

In January, 1952, customer service was greatly improved by the establishment of a branch warehouse in Decatur. This location was selected because it was the hub of the north Alabama industrial area and return trips from the Birmingham warehouse could be completed within

EXHIBIT 2

MAP OF NORTH ALABAMA INDUSTRIAL CENTERS



the 10-hour maximum driver time allowed by Alabama state law.

Approximately 500 of the most active items in the electrical and plumbing equipment and supply and building materials lines were stocked at this warehouse. The establishing of this warehouse changed the procedure for handling customer orders as follows: (1) Orders from customers and salesmen were processed at the Decatur warehouse. (2) All orders for items carried in stock were scheduled for delivery. (3) Orders for items not carried in stock were combined and transmitted to the Birmingham warehouse. (4) All orders received during the day at Birmingham would be shipped by company trucks to the Decatur warehouse during the night. (5) Customer trucks picked up most of the shipments. The balance of the deliveries were made by common carrier. In most cases, customers received delivery on the day following receipt of the order.

This new procedure greatly improved customer service but did not result in any marked reduction in cost as the elimination of long-distance minimum charge shipments by common carrier was offset by the cost of carrying a $200,000 inventory at the Decatur warehouse.

Personnel under the direction of the vice-president in charge of operations continued to study delivery methods which would reduce the operating costs for this area. In October, 1954, after extensive investigations and cost analysis, it was decided to substitute a break-out terminal for the Decatur warehouse and to locate two company-owned trucks in Decatur to make local deliveries. This change, which eliminated the inventory in Decatur, required a revision in the procedure for handling customer orders as follows: (1) All orders were transmitted to the Birmingham office where they were processed and scheduled for shipment from the Birmingham warehouse. (2) Company-owned tractor-trailer units would make nightly runs to the break-out terminal in Decatur. (3) Upon arrival at the terminal in Decatur, the trailer would be unloaded and the orders route-loaded[1] into straight trucks for local delivery. This change in procedure, which required that all deliveries be made by just two company trucks, limited the area of delivery which could be covered in any one day and presented management with the problem of maintaining the 24-hour delivery service previously accomplished by using customer pick-up and common carrier.

Coordination between sales managers and the Operations Division solved this problem. All salesmen's routes within the territory were synchronized with the delivery routes so that salesmen would call on customers approximately 24 to 36 hours prior to the time when a truck would be scheduled to take that particular delivery route. Thus, the change in procedure did not materially effect customer service as, in most cases, deliveries still could be made on the day following receipt of the orders. This change in procedure did, however, result in considerable cost reduction as the cost of maintaining two company-owned trucks in

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[1] Route loading is loading merchandise in order of stops as the delivery unit works an area. Each customer in an area is assigned a number which appears on the working copy of the order so that warehouse personnel will work and load orders in proper sequence.

Decatur was more than offset by substituting terminal costs for warehouse costs and by eliminating the costs associated with the carrying of a $200,000 duplicate inventory at the Decatur warehouse.

At the same time that operating personnel were making studies of the Decatur operation, they also were studying ways to reduce the cost of shipments from the Birmingham warehouse to the Nashville Division. If customer service were to be given top priority, nightly runs from Birmingham to Nashville would be required even though full trailer loads were not always possible. One suggestion for eliminating the less-than-trailer load shipments to Decatur and Nashville was to develop a locked trailer insert which could be loaded out of Birmingham on a trailer destined for Nashville and dropped off on the loading ramp at the Decatur terminal. Some thought was given to designing the insert containers so that empties could be collapsed and stacked for return shipment. Methods of loading and unloading these inserts and particulars of design had not been perfected when the Morhaul cargo container and hydraulic lift were invented by two Moore-Handley employees, B. H. Wells, superintendent of the Birmingham warehouse system, and W. J. Shaw, supervisor of the truck maintenance section.

EXHIBIT 3

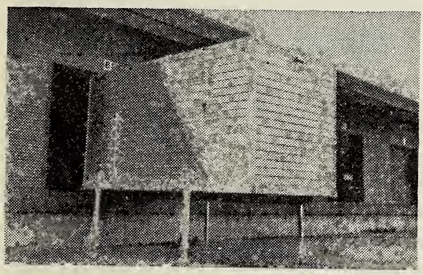
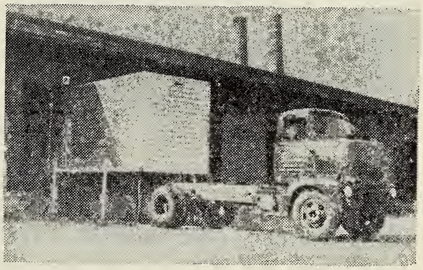


EXHIBIT 4



This revolutionary new idea in delivery equipment consisted of a cargo container, designed to fit the needs of particular business concerns, and a truck or trailer chassis equipped with a Morhaul hydraulic lifting device. The cargo container (Moore-Handley uses van-type containers approximately the size of a straight truck body) is equipped with self-contained retractable stands or leg supports (Exhibit 3). When not being used as a mobile unit, the cargo container stands on its own legs approximately 4 feet off the ground. To convert this stationary container into a mobile unit requires a truck or trailer equipped with a Morhaul hydraulic lift. The truck or trailer backs under the container (Exhibit 4) and using its hydraulic lift, raises the container off of the ground (Exhibit 5). The retractable legs are then released and secured in the four slots on the body of the container. The hydraulic lift then lowers the container to the truck chassis where it is made secure by four clamps. The truck and container are then ready to operate as a single unit vehicle (Exhibit 6).

EXHIBIT 5

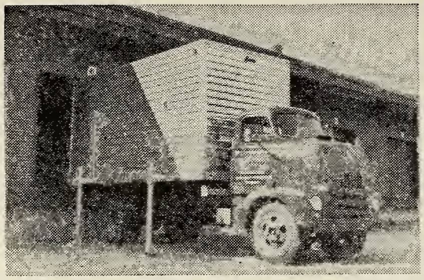


EXHIBIT 6

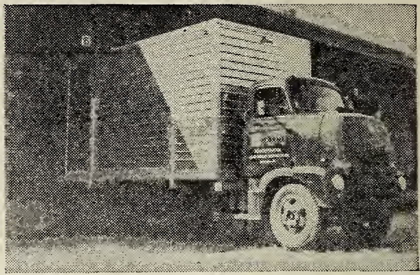


EXHIBIT 7

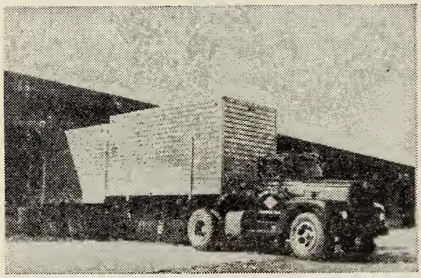
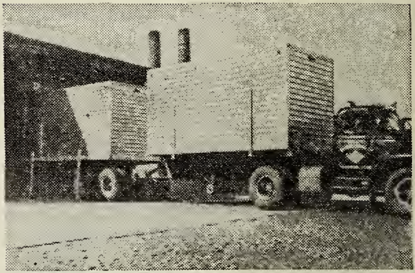


EXHIBIT 8



To detach a container from a truck, the procedure is reversed. The first step is for the driver to activate the truck's hydraulic lift and raise the container approximately 2 feet. The container legs are then dropped to the ground and secured in position by steel pins. The hydraulic lift is then lowered to the truck bed, freeing the container and permitting the truck to pull away from the container.

Further development of the Morhaul equipment resulted in equipping trailers and semitrailers with hydraulic lifts so that two or more containers, equipped with Morhaul stands, could be transported by the same prime mover (Exhibit 7). This arrangement permits the spotting of route-loaded containers for local pick-up and delivery service without tying up the prime mover which can transport its remaining containers to other locations (Exhibit 8).

Operating costs are greatly reduced when Morhaul equipment is used because: (1) Trucks do not have to stand idle while containers are being loaded. They can be making deliveries from other containers. (2) There is no license tag needed for cargo containers, only for the truck or the trailer used to transport the container. (3) Units are driver operated. (4) Containers can be route-loaded at a central warehouse and shipped to distant terminals where the local deliveries can be made without rehandling the cargo. This procedure is used by Moore-Handley in its Decatur operation and in making shipments to its customers in the Atlanta area. (5) Several containers can be serviced by one prime mover thus using expensive motor equipment more efficiently. (6) Rehandling charges are eliminated by route loading containers from central warehouses for distant area delivery, thus eliminating the need for branch warehouses and duplicate inventories. (7) Losses from damaged and stolen merchandise are reduced because fewer handlings are required.

The Morhaul unit became operational during the summer of 1955, and in November of the same year management decided to use Morhaul equipment to service the Decatur area.

Capitalizing on the advantages of this new equipment, the procedure for handling customer orders was changed as follows: (1) All orders were processed by the Birmingham office and sent to the Birmingham warehouse for shipment. (2) Morhaul cargo containers were route-loaded at Birmingham and transported, two at a time, by company owned tractor-trailer units equipped with Morhaul hydraulic lifts to the Decatur terminal. (3) Straight trucks, equipped with Morhaul hydraulic lifts, would pick up the route-loaded containers and make the local deliveries.

The use of Morhaul equipment eliminated the need for terminal facilities and when the lease on the Decatur terminal expired in October, 1956, arrangements were made with a gasoline service station to park Morhaul units on their property in exchange for the gasoline, oil, and maintenance business of the two local delivery trucks.

The following detailed analysis of the Decatur operation before and after Morhaul units were put in service shows how Moore-Handley was able to reduce costs while maintaining a 24-hour delivery service.

Prior to the invention of the Morhaul equipment, a tractor-trailer rig had been dispatched nightly from the Birmingham warehouse to the Decatur terminal which is approximately 100 miles distant. At Decatur, Moore-Handley had two drivers stationed with two straight trucks for delivery within 50 miles of the terminal, one usually covering the Tri-Cities area, the other the Huntsville area. This arrangement required the dispatching of the trailer from the Birmingham warehouse by 2 A.M. so as to arrive in Decatur by 5 A.M. where it was met by the two local drivers. The three drivers would then unload the trailer and route-load the straight trucks for local delivery. This transfer of cargo from the trailer to the straight trucks usually took from 5 A.M. until approximately 8 A.M. each day.

The tractor-trailer driver would then return to the Birmingham warehouse arriving at approximately 1 P.M. The straight truck drivers usually made about 35 local delivery stops which kept them on the road approximately eight hours a day. This procedure, although keeping all three drivers within the legal 10-hour driving period per day, resulted in the paying of nine hours overtime at driver rates for transferring the cargo from the trailer to the trucks.

The introduction of Morhaul equipment to service this area eliminated not only the overtime payments to the drivers but also the rent for terminal facilities. Under the present operating procedure, a Morhaul trailer with two route-loaded Morhaul containers arrives in Decatur sometime during the night. These containers are spotted and two empty containers are picked up for the return trip to Birmingham. The total elapsed time for spotting the loaded containers and picking up the empties is approximately 20 minutes. At 8 A.M. the two straight truck drivers pick up their loaded containers and deliver their routes.

EXHIBIT 9

COST COMPARISON OF DECATUR DELIVERY PROCEDURES

Method Prior to Morhaul	
Equipment	
1 tractor @ $5,500	$ 5,500
1 trailer @ $4,400	4,400
2 trucks with bodies @ $4,100	8,200
Total equipment	$18,100
Cost of money at 6 percent per year	$ 1,086
Taxes, tags, and insurance	800
Rent of terminal	2,400
Tractor driver wages, 8 hours @ $2.50	5,200
Tractor driver overtime loading trucks, 3 hours @ $3.75	2,925
2 straight truck drivers delivery time, 8 hours each @ $2.00	8,320
2 straight truck drivers overtime loading and unloading, 3 hours each @ $3.00	4,680
Loading by dock crew of regular trailer, 6 hours @ $1.45 (total—1,560 hours/year)	2,262
Total operating costs	$27,673

Morhaul Method	
Equipment:	
1 tractor @ $5,500	$ 5,500
1 33-foot Morhaul trailer @ $6,285	6,285
2 trucks with Morhaul lifts @ $4,200	8,400
4 containers with stands @ $1,700	6,800
Total equipment	$26,985
Cost of money @ 6 percent per year	$ 1,611
Taxes, tags, and insurance	800
No terminal needed	
Tractor driver wages, 8 hours @ $2.50	5,200
Tractor driver overtime exchanging containers, ⅓ hour @ $3.75	325
2 straight truck drivers delivery time, 8 hours each @ $2.00	8,320
2 straight truck drivers overtime dismounting empties and mounting route-loaded bodies, ⅙ hour @ $3	260
Route-loading by dock crew of Morhaul containers, 10 hours @ $1.45 (total—2,600 hours/year)	3,770
Total operating costs	$20,286

Morhaul method saves $7,387.00 per year

Operating personnel estimate that the introduction of Morhaul equipment to service the Decatur area has resulted in a cost savings of over $7,000 a year. Comparative cost figures compiled by the operating division are used to substantiate this estimate (Exhibit 9).

The Mobile Operation

The successful introduction of Morhaul equipment to service the Decatur area prompted management to investigate the possibilities of using Morhaul to give better service at lower cost in other divisions of the company. The Mobile Division was selected for study because of its size and its important contribution to the profitable operations of the business.

Following the pattern established for the Decatur operation, a delivery procedure was contemplated for orders which required transshipment from the Birmingham warehouse to customers in the Mobile area. This procedure was outlined as follows: (1) Orders from customers and salesmen would be processed by the Mobile office. (2) Orders for items carried in stock would be scheduled for delivery. (3) Orders for items not carried in stock would be combined and transmitted to the Birmingham warehouse. (4) Orders received during the day at Birmingham would be route-loaded in Morhaul containers and shipped to the Mobile warehouse that night. (5) Straight trucks equipped with Morhaul lifts would pick up the route-loaded containers at the Mobile warehouse and make the local deliveries. This contemplated delivery procedure differed from that used to service the Decatur area in that: (*a*) The Mobile Division was a major installation consisting of a sales force, an office operation consisting of order service personnel and buyers, and a warehouse and delivery fleet. No thought was given to discontinuing the warehouse at Mobile which was able to serve many of its customers from the items normally carried in stock, and (*b*) Some of the items carried in inventory at Birmingham were shipped by the manufacturers through the port of Mobile and had to be transshipped to the central warehouses in Birmingham. This activity required that office and warehouse personnel be located in the Mobile area.

Management listed the benefits to be derived from the proposed delivery procedure as: (1) Enable us to cut our office force and warehouse employees without having to add nearly as many people at the main plant in Birmingham. (2) Centralize our control. (3) Reduce our inventory by over one-half a million dollars, and (4) Reduce our rent for physical facilities by over 50 percent.

Further investigations by operating personnel revealed the following conditions peculiar to the Mobile operation: (1) A service pattern characteristic of this area was for customers to call at the warehouse to pick up their shipments. As a high percentage of orders were filled in this manner and as competitors in the industrial distribution field maintained facilities to service customers in this manner, management decided it would be unwise to attempt to change from a "will-call" to a full delivery service. On a "will-call" basis, there was no advantage in route-loading shipments from Birmingham as it would be more costly at the Birmingham end and would not reduce the handling costs in Mobile. (2) Mobile is approximately 265 miles from Birmingham. Driver time for tractor-trailer shipments from the Birmingham warehouse to Mobile is approximately seven hours. Thus, conforming to state law, drivers must lay over eight hours in Mobile before making the return run to

Birmingham. This condition eliminated the need for rapid unloading of the trailer at the Mobile warehouse. (On the Decatur run, rapid unloading or interchange of bodies was necessary in order that the return trip to Birmingham be completed within the 10-hour driver time permitted by law.) (3) The back-loading of trucks from Mobile was an important consideration due to the distance involved. Besides the few shipments destined for Birmingham which had been routed through the port of Mobile, the only other cargos available were those exempt under the Interstate Commerce Commission regulations, fresh fruits and vegetables. To transport these commodities, refrigeration was necessary. Cost analysis revealed that the most economical equipment available was an insulated van-type trailer fitted with an ice bunker which could be loaded when transporting perishable commodities. When transporting regular Moore–Handley products, this vehicle could be used as a regular van-type trailer. (4) The great activity in the Mobile area required a continuing restocking of the warehouse to replenish items sold on a "will-call" basis.

Management weighed the four conditions mentioned above against the known advantages of using Morhaul equipment and decided that, for the time being, it would be to their advantage to use tractor and insulated trailer rigs for shipments between the Birmingham and Mobile warehouses.

The intensive investigations into the transportation problems of the Mobile Division revealed several local delivery operations which warranted further study for cost reduction. One of these operations involved using one straight truck in an effort to deliver in two areas on alternating days, one 60 miles east, the other 70 miles west of the Mobile warehouse. Each of these delivery runs took approximately 10-hours driver time and it was always after regular closing time when the trucks returned to the warehouse. The loading of the truck at night so as to be ready for early morning departure required one supervisor and two loaders working for two and one-half hours overtime. This overtime pay amounted to $2,600 a year.

Two suggestions for eliminating these overtime payments were considered by management: (1) Buy a straight truck costing $5,400 which would be available for loading during the regular working hours of warehouse employees. Loading costs would thus be reduced to approximately $520 a year. This change, in effect, would assign two trucks to the one driver and would eliminate night loading for early morning delivery. (2) Convert the existing equipment by installing a Morhaul hydraulic lift on the truck chassis and Morhaul stands on the truck body. Buy an additional Morhaul container. With this equipment, one container could be left at the loading dock while the other container was being used to make deliveries.

This procedure would result in the same cost reduction in handling charges as calculated for suggestion (1) above but would not require as great a capital outlay as the acquisition of an additional truck. Cost comparisons prepared by operating personnel for the existing delivery method with suggestions No. 1 and No. 2 are shown below on an annual basis:

	Old Delivery Method (1 truck)	*Suggestion No. 1 (2 trucks)*	*Suggestion No. 2 (Morhaul)*
Investment—equipment	$5,400	$10,800	$9,380
Operating costs:			
Depreciation—5 years	$1,080	$2,160	$1,876
Insurance and taxes	250	500	250
Driver wages	5,000	5,000	5,000
Loading costs	2,600	520	520
Total operating costs	$8,930	$8,180	$7,646
Savings over old delivery method		$ 750	$1,284

In the above situation, the replacement of the one straight truck with Morhaul equipment shows a cost reduction of over 14 percent. This savings was attributed to: (1) No license or special insurance are needed for Morhaul cargo containers. The truck license and insurance cover the Morhaul container when it is being used as a truck body and when the container is detached from the truck, the insurance policy covering the warehouse and contents also covers the Morhaul container. (2) While being loaded at a warehouse, a Morhaul container serves the same purpose as a truck but is less expensive.

The Calculation of Savings

A consultant reviewing the techniques used to calculate the savings shown above for the Mobile operation and in Exhibit 3 for the Decatur operation made the following observations:

A. Any reduction in operating costs will be offset partially by an increase in federal and state income taxes. In calculating this increase in income taxes, only book figures should be used with depreciation and interest paid for the use of borrowed money treated from a tax point of view.

B. To evaluate the several possible alternatives being considered, a separate calculation must be made which considers the economic benefits of alternative solutions determined without reference to tax law requirements. It should be noted, however, that any increase in the income tax liability due to reduced operating costs must be considered as an expense in making the economic analysis. Conversely, any increase in operating costs will reduce the income tax liability which should be considered in making the economic analysis.

C. Costs common to alternative solutions to problems may be ignored in compiling data thus eliminating much detail and allowing analysts to concentrate on changes in the cost pattern.

D. Seven basic areas which should be considered in costing alternative courses of action are:

1. Cost of maintaining inventories.
2. Cost of occupancy.
3. Cost of equipment.
4. Cost of insurance and taxes on equipment.
5. Cost of labor and equipment operation.
6. Income taxes on cost savings and disposition of capital assets.
7. Capital requirements.

Care must be exercised to distinguish between observations (A) and (B) when considering D–1, D–2, D–3, and D–7.

A detailed analysis of the seven basic areas for consideration listed in (D) above is given below:

D–1. The following costs should be considered in determining the cost, for tax purposes, attributed to the maintenance of inventories: (*a*) Insurance on inventory. (*b*) Taxes on inventory. (*c*) Losses from damaged or stolen merchandise. (*d*) Average interest expense incurred to finance inventory with borrowed funds.

When determining the cost of maintaining inventories from an economic or management point of view, an amount equal to the average investment in inventory financed by company funds multiplied by the cost of money should be added to the total cost calculated for tax purposes. For this type of analysis, cost of money may be defined as either the current interest rate at which long-term bonds could be issued, the going money rate for short-term loans, or the rate a particular company earns on its invested capital calculated before interest charges. The first mentioned rate is preferred because it more nearly represents the rate at which equity capital can be obtained.

D–2. Occupancy costs for rented facilities consist of: (*a*) Rent. (*b*) Insurance on physical facilities. (*c*) Utilities. (*d*) Other maintenance costs.

When the physical plant is owned by the subject company, mortgage interest and property taxes should be substituted for rental costs.

To determine the cost of occupancy for tax purposes, depreciation charges should be added to the above total. However, when occupancy costs are considered from an economic or management point of view, the cost of investment in property should be substituted for depreciation charges. The cost of an investment in property can be calculated by multiplying the average investment[2] by the cost of money.

When physical facilities are disposed of due to the elimination of the need for such facilities, the net capital made available for investment should be determined after taxes and the payment of any mortgage obligations. The net capital made available by the disposal of physical facilities should be considered in conjunction with the capital requirements needed for equipment acquisitions.

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[2] For depreciable assets, the average investment is one half of the total of cost and the book value of the property at the beginning of its last year of useful service. For property not subject to depreciation, the average investment is cost.

D–3. In costing equipment acquisitions and dispositions, consideration need be given only to those items which will be affected by the proposed change. Separate calculations for the present equipment and the proposed equipment will have to be made to determine any changes in depreciation charges.

The calculation of depreciation charges for the various proposals will require consideration of the depreciation techniques used by the subject company only if separate calculations are to be made to figure pay-back on an annual basis. (Pay-back is the number of years it will take for annual savings to pay back the additional capital investment.) If an average annual savings is considered satisfactory for analytical purposes, depreciation should be figured by the straight line method with the economic life of the asset used to determine the depreciation rate. Using the straight line method of depreciation eliminates the need to defer any income tax liability because of the depreciation method used for tax purposes. This point is illustrated in the following example:

Assume a company depreciates a piece of equipment costing $4,200 by a reducing fraction (sum of the digits) method over a four-year period for tax purposes but that the economic life of the asset is estimated to be six years. Depreciation charges for tax purposes would be $1,680, $1,260, $840, $420, $0, and $0 during the six-year life of the asset. Calculating depreciation by the straight line method over the six-year life of the asset would amount to an annual charge of $700.

If the required investment for additional equipment is material in amount, it appears advisable to calculate the savings on an annual basis using the depreciation method that is used for tax purposes. If other than a straight line method is used for tax purposes, the charge will decrease each year resulting in an increase in the tax liability as reflected in the analysis of cost savings. Under these conditions, pay-back calculations will have to be made separately for each year.

The straight line method for depreciating assets, which will show an average cost savings over the economic life of an asset, is deemed sufficiently accurate for most analytical purposes and will reflect an average annual savings for comparative purposes.

Calculations for depreciation will be used only in determining the income tax change resulting from the increase or decrease in operating costs.

In making an economic analysis of the financial benefits of a proposed change in equipment, calculations are needed to determine the cost of the average added investment in equipment. The cost of new equipment is determined by deducting from cost the scrap or trade-in value of equipment disposed of or the fair salable value of equipment transferred to other uses. This adjusted cost figure should be amortized over the useful economic life of the asset in calculating the net average added investment in equipment. If assets are disposed of, consideration should be given to the resulting change in income tax liability.

D–4. The cost of insurance and taxes on equipment includes all expenditures for insurance, licenses, road taxes, property taxes, and city, county, or state operating licenses. This last mentioned privilege tax might be considered under the D–5 classification if it is a tax on the right to do business in a given area rather than a tax on the delivery equipment operating in the area. A simple test to determine the proper classification of this tax is to ascertain whether or not it will exist if a common carrier makes the deliveries in a given area. If the tax is assessed when deliveries are made by common carrier, the tax is properly listed under the D–5 classification, otherwise it should be listed under the D–4 classification.

D–5. Costing labor and equipment operation is greatly simplified if functional subdivisions are made of this classification. The items to be included under each of these subdivisions will depend, to a great extent, on the type and size of the company involved and the services rendered to its customers. In most cases, subdivisions for: (*a*) receiving and shipping, (*b*) transporting and delivery, (*c*) damaged goods, (*d*) production, and (*e*) material handling, will suffice as a starting point with more detailed breakdowns necessary only when alternative actions are being considered for a particular subdivision.

When considering labor costs, special attention should be given to payroll taxes and the cost of fringe benefits if there is a material difference between payroll calculations for alternative courses of action.

Costing equipment operation involves consideration of all operating costs not covered under classifications D–1 through D–4.

D–6. The calculation of increases or decreases in federal and state income taxes resulting from changes in the cost of operations must, by necessity, be computed in accordance with the tax accounting procedures used by the company with the one exception of depreciation calculations analyzed in D–3.

Tax increases or savings resulting from the sale of capital assets must be considered when calculating the net capital made available by the disposition of capital equipment. Gains or losses on the disposition of capital assets, however, should not be considered in computing the cost of operations but should be treated as extraordinary gains or losses.

D–7. The ascertainment of capital requirements necessitates consideration of the acquisition and disposition of all capital assets and the consequences of the income tax treatment of each asset. All changes in the required investment in capital assets as reflected under D–2 and

D–3 classifications must be considered in arriving at the net added capital investment required for alternative solutions.

The basic principles mentioned above are applied to the "Cost Comparison of Decatur Delivery Procedure" (Exhibit 3) to illustrate their application. Each step in the computation will be referred to one or more of the above observations in lieu of detailed explanations.

To supplement the data shown in Exhibit 3, the following information was obtained from company records:

1. Existing truck chassis could be equipped with Morhaul hydraulic lifts at $1,400 per unit.
2. Existing truck bodies could be equipped with Morhaul stands at $600 per unit.
3. Trucks and trailers are depreciated over a five-year period by a reducing fraction (sum of the digits) method.
4. The two trucks used for local delivery were converted to Morhaul equipment per (1) and (2) above.
5. The transport trailer which had an estimated value of $1,760 was transferred to another run and a new 33-foot Morhaul trailer was acquired at a cost of $6,285.

Computations showing the average annual depreciation charges for inclusion as D–3 in Exhibit 4, "Cost Savings Calculations for Tax Purposes" are shown in Schedule No. 1 below:

SCHEDULE NO. 1
Cost of Equipment

1 Morhaul trailer	$ 6,285
Less value of old trailer	1,760
Adjusted cost for tax purposes	$ 4,525
2 Morhaul lifts to convert truck chassis	2,800
Total cost of equipment with 5-year life	$ 7,325
Annual depreciation (straight line method)	$ 1,465
Convert 2 truck bodies with Morhaul stands	$ 1,200
2 Morhaul containers @ $1,700 each	3,400
Total cost of equipment with 10-year life	$ 4,600
Annual depreciation (straight line method)	$ 460
Net additional investment required	$11,925

With the exception of the calculations for equipment depreciation, the techniques used in Exhibit 10 to determine the average net annual savings resulting from the adoption of the Morhaul system are those accounting procedures used by the subject company to determine the tax liability.

The net savings shown in Exhibit 10, being based on the accounting procedures used to determine the income tax liability, do not necessarily reflect the economic benefits of the Morhaul system. The actual economic advantages of the Morhaul system, including an average increase in federal and state income taxes resulting from the reduction in operating expenses, is shown in Exhibit 11.

EXHIBIT 10

MOORE-HANDLEY HARDWARE COMPANY, INC. (A)
Cost Savings Calculations for Tax Purposes
(Observation A)

		Present Method	*Morhaul Method*
D–1	Cost of maintaining inventory: No inventory involved		
D–2	Cost of occupancy: Terminal rent	$ 2,400	. . .
D–3	Cost of equipment		
	Depreciation of equipment with		
	5-year life (see Schedule No. 1)		$ 1,465
	10-year life (see Schedule No. 1)		460
	Depreciation of present trailer, cost $4,400—5-year life	880	
D–4	Cost of insurance and taxes: Cost common to both methods, see Observation C.		
D–5	Cost of labor and equipment operation		
	Driver wages	21,125	14,105
	Loaders' wages	2,262	3,770
	Payroll taxes and fringe benefits	1,235	944
	Totals	$27,902	$20,744
	Net savings before income taxes		$ 7,158
D–6	Federal and state income taxes (53.2 percent)		3,808
	Net savings after taxes		$ 3,350

EXHIBIT 11

MOORE-HANDLEY HARDWARE COMPANY, INC. (A)
Cost Savings of Morhaul System
(Observation B)

			Present Method	*Morhaul Method*
D–1	Cost of maintaining inventory: No inventory involved			
D–2	Cost of occupancy: Terminal rent		$ 2,400	. . .
D–3	Cost of equipment			
	Average investment in trucks and trailers with estimated life of 5 years	$4,395		
	Average investment in bodies with estimated life of 10 years	2,530		
	Total average investment	$6,925		
	Cost of money	4%		
	Cost of added investment in equipment (average long-term bond interest rate used as cost of money)			$ 277
D–4	Cost of insurance and taxes: Cost common to both methods			
D–5	Cost of labor and equipment operation: See Exhibit 4 for calculations		24,622	18,819
D–6	Federal and state income tax increase (See Exhibit 10 for calculation)			3,808
	Totals		$27,022	$22,904
	Net savings of Morhaul system			$ 4,118
D–7	Capital requirements			
	Net additional capital required (see Schedule No. 1)			$11,925
	Net savings of Morhaul system			4,118
	Pay-back period (years)			2.9

*Moore-Handley Hardware Company, Inc. (B)**

The Sale of Morhaul Equipment

The experiments with Morhaul equipment proved so successful in reducing operating costs that, in 1957, it was decided to put Morhaul on the general market to help other companies solve transportation problems similar to those encountered by Moore-Handley. The Special Products Division was created to market this equipment, and arrangements were made with several trailer and truck body manufacturers to fabricate Morhaul equipment under Moore-Handley patents. This venture marked the first time that Moore-Handley had ever put a product on the national market. (It is now sold internationally.)

Within a relatively short period of time, Morhaul equipment was solving transportation problems for many companies in all sections of the country. The Kroehler Manufacturing Company, the world's largest furniture manufacturer, is an outstanding example of a firm that has gotten excellent results with Morhaul-equipped containers and trailers equipped with Morhaul hydraulic lifts.

The Kroehler Manufacturing Company was faced with the problem of how to eliminate the rehandling of furniture brought to a large metropolitan city by a tractor-trailer rig which was too large to be taken into the congested downtown area. (Many cities have ordinances which prohibit the use of large tractor-trailer rigs in downtown or congested areas.) To use smaller over-the-road units would not be economical as shipments of furniture usually "bulked out" before they "weighed out."[1]

The availability of Morhaul equipment solved this problem, and today Kroehler is using a 40-foot single level lift Morhaul trailer to deliver two 20-foot route-loaded Morhaul containers to the outskirts of the city. There the tractor driver dismounts the two containers from the trailer and picks up two empties for the return run to the factory. A city driver, with a smaller tractor-trailer rig equipped with a Morhaul lift, then mounts the loaded containers, one at a time, and makes the local deliveries.

Below are listed six advantages accruing to the Kroehler Manufacturing Company because of its changeover from conventional delivery equipment to Morhaul equipment: (1) Faster delivery to customers. (2) Reduction in costs because of the elimination of two handlings. (3) Reduction in damaged merchandise. (4) Road unit is kept busy rolling up ton miles. (5) Elimination of dock space required for unloading the trailer and loading the city delivery trucks. (6) Reduction in driver fatigue.

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* Prepared by Frederic A. Brett, University of Alabama.

[1] All van-type truck bodies and trailers are cargo rated as to cubic content and weight. A van is said to "bulk out" when loaded to its maximum cubic capacity before the weight limit has been reached, and is said to "weigh out" when loaded to its weight limit before using up its cubic capacity.

Another progressive company like the Kroehler Manufacturing Company, that was among the first to adapt Morhaul equipment to their own needs, is the Mobil Oil Company.

The Mobil Oil Company faced a much different distribution problem in that two warehouses, a branch warehouse in Albany, New York, and a sub-branch warehouse in Utica, New York, were needed to service the central New York area with lubricants in cans and drums, tires, batteries, and accessories. The Utica warehouse, which is 90 miles from Albany, was stocked by semiweekly runs from the Albany warehouse and by small LTL shipments from suppliers. Two trucks with drivers were stationed at the Utica warehouse to make local deliveries.

The installation of Morhaul equipment to service the Utica area resulted in the elimination of the Utica sub-branch warehouse and all costs associated with the labor force used to load trucks and maintain local inventories of Mobil products. Morhaul equipment, including equipping an extra standby truck, was acquired at a total cost of $23,430. Amortizing this investment on a four-year basis as a charge against the estimated $20,000 a year savings in operational costs resulted in a net annual savings of $14,142.

The following procedure is now used to service the Utica area from the Albany warehouse: (1) All shipments are received at the Albany warehouse. This procedure gives better stock control and reduces the required inventory investment. (2) Salesmen telephone orders, previously serviced by the Utica warehouse, directly to the Albany warehouse. (3) Two containers are route-loaded in Albany for transport by Morhaul train to Utica. (A train is made up of a straight truck equipped with a Morhaul lift and a four-wheel Morhaul trailer, each carrying a route-loaded 18-foot Morhaul container.) (4) The train travels from the Albany warehouse to Utica during the night. (5) At Utica, the one route-loaded container on the trailer is exchanged for an empty. The transport truck and loaded container are exchanged for one of the trucks and empty container which had been used that day for local deliveries. (6) The empty train returns to Albany. (7) The following morning, the trailer transported container is picked up by a truck with a Morhaul lift and both containers are ready for their local delivery runs. The technique of alternating the trucks used for the Albany to Utica train eliminates one exchange of containers each night and equalizes the total miles each truck is operated in a given period of time.

Mr. Luther Doty, Manager of the Special Products Division, envisions many diversified uses for Morhaul equipment. Some of these uses, many of which are in the development stage, are: (1) Containers for use by the Post Office Department for mail and parcel post shipments. (2) Containers and lift equipment for use by the military in solving logistic problems. An amphibious transporting vehicle could unload a supply container on a beach; then a land-based chassis would pick up the container for delivery inland. (3) Specially designed containers for use by motion picture companies to be used as dressing rooms, prop storage rooms, and workshops while movies are being filmed on location. (4) Containers which can be used by furniture movers to store furniture in a vacant lot until a family is ready to move into a new home, thus saving costly warehouse space and material handling. (5) Containers equipped with communication apparatus for use in disasters or as television or radio remotes for use in covering special events. (6) Containers adapted for air-lifting by helicopter from city to city. This use is presently being considered by a food chain for supplying its supermarkets from central supply points.

CASE PROBLEMS

The following case problems are designed to illustrate the ideas and technical notes incorporated in both cases (A) and (B).

Costing Proposed Sale of Equipment to Able Company

A delivery service was concerned with the high cost of delivering 18 truck loads of assorted packaged merchandise a day to customers in a large metropolitan area. The present operation involved 12 straight trucks with van-type bodies which were loaded at night for early morning delivery. The approximate delivery time per truck was from two to four hours. As trucks completed their runs, they would return to the loading dock where they would be loaded for afternoon delivery. Each truck was routed so as to spend approximately six hours a day making deliveries and two hours a day being loaded. This loading time was in addition to the time spent in loading the trucks at night.

The present equipment had been purchased at a total cost of $50,400 against which depreciation of $17,640 had been taken. All trucks were being depreciated for tax purposes over a five-year period. The actual life of the trucks, however, was estimated to be seven years. The present salable value of the average truck was estimated to be $3,100.

Truck drivers were paid $2 per hour for an eight-hour day with time and a half for overtime. Loaders were paid $1.45 per hour. Payroll taxes and fringe benefits amounted to 6.2 percent of the total payroll.

Truck licenses, property taxes, and insurance totaled $250 per truck per year.

Operating management was considering converting their equipment to the Morhaul system and had accumulated the following data:

1. Existing truck chassis could be equipped with Morhaul hydraulic lifts at a unit cost of $1,400.
2. Existing truck bodies could be equipped with Morhaul stands at a unit cost of $600.
3. New cargo containers equipped with Morhaul stands could be purchased for $1,800 per unit.
4. New truck chassis equipped with Morhaul hydraulic lifts could be purchased for $4,400 each.
5. It was estimated that detachable cargo containers would have a useful life of 10 years.

Costing Proposed Sale of Equipment to Baker Company

The Baker Manufacturing Company has two factories in the same city some distance apart. Each factory performs work on the semifinished product so that subassemblies and parts must be transported from Plant A to Plant B.

To handle the interplant traffic, three trucks, all operated by the same driver, are used in the following order: While truck No. 1 is being loaded at Plant A, truck No. 3 is being unloaded at Plant B. Truck No. 2 is at Plant A ready for loading as soon as truck No. 1 has been loaded. When truck No. 1 is loaded, the driver takes it to Plant B for unloading. He then picks up truck No. 3 which has been unloaded at Plant B and drives it to Plant A. During the time it takes the driver to make a round trip between Plant A and B, truck No. 2 is loaded at Plant A. As soon as he spots truck No. 3 for loading at Plant A, the driver picks up truck No. 2 and drives it to Plant B. This process is continued for eight hours a day, five days a week.

One of the trucks used in this operation has been fully depreciated for tax purposes and has an estimated scrap or trade-in value of $400. The other two trucks were acquired the previous year at a unit cost of $4,200 and have been depreciated $840 each for tax purposes. The actual life of these trucks is estimated at eight years and the estimated fair salable value of these trucks is $3,000 per unit.

Truck licenses, property taxes, and insurance total $200 a year per truck.

Management is considering converting the existing equipment to Morhaul units. Cost data for this conversion are the same as given for the Able Company.

The vice-president in charge of operations is very enthusiastic about the proposed conversion to Morhaul equipment but the president is a bit hesitant about giving his approval because working capital is low and any capital equipment purchases will have to be financed at 6 percent interest.

The vice-president in charge of operations in presenting his proposal stated that it would cost only an additional $200 to install the Morhaul system as $4,200 would have to be expended anyway to replace the worn-out truck.

Pioneer Oil Company[*]

I.

The Pioneer Oil Company is a major integrated oil company,[1] which had its beginning in the Southwest in the 1890's, and became a Standard Oil Company affiliate in Standard's efforts to keep pace with the expansion of the industry westward from the Appalachian area.

After the historic split up of the Standard Oil group by Supreme Court decision on May 15, 1911, the company was on its own. The company strengthened its position by merging with the Supreme Oil Company in the 1920's and grew to its present position, as one of the 20 largest oil companies, doing business in a 30-state marketing area with general offices in Kansas City, Missouri. Supreme Oil Company was an integrated oil company also, and had a total of about 5,000 retail outlets in the Midwest, the East coast, and in Canada. In the retrenchment program decided upon during the depression, Pioneer pulled back closer to the supply points, and in Illinois, all properties east of a line running roughly from Rockford to Cairo were sold, leaving 12 widely scattered bulk plants and about 20 service stations remaining in the state.

In 1929 Pioneer operated one bulk plant and one service station at Marble City, Illinois, a city with a present population of about 50,000. The station, hereafter known as Station A, is located on the northwest corner of an intersection about four blocks from the center of the business district. It has a 60-foot frontage on the primary street and 130 feet on the secondary street. The primary street is a block from, and runs parallel with, Main Street which leads to the downtown area; both Main and the primary street are heavily traveled and the station averaged sales of about 11,000 gallons of gasoline per month after World War II.

Originally the station building consisted of an office only, with an outside pit for servicing automobiles. In 1937, a single service bay was added to provide lubrication and washing facilities.

The bulk plant was operated on a commission agency basis,[2] but a succession of agents, even when operating on a company guaranteed minimum earnings, had all failed. The plant was sold in 1946, and the service station was supplied by the commission agent at Greensburg, about 20 miles north of Marble City.

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[*] Prepared by William H. Day, University of Tulsa.

[1] A major integrated oil company is defined as a company which participates in all phases of the oil industry, that is, exploration, drilling, transportation, refining, and marketing, on a major scale under a nationally recognized brand name.

[2] Bulk plants are either company owned or privately owned. Company-owned bulk plants may be operated on a salaried or commission basis. When operated on a commission basis, all petroleum stocks are consigned, and the agent receives a commission on the petroleum products he sells. An individual who owns a bulk plant is known as a jobber and he may sell branded or unbranded (private brand) products as he sees fit. Jobber's margins are higher than the agent's commission, since the jobber has the total investment and risk in the plant, equipment, inventory, and accounts receivable.

Pioneer Oil Company's bulk plants in central Illinois received light oils on an exchange agreement from Leland Refining's terminal at Springfield, Illinois, as freight costs on their own products were prohibitive from the nearest terminal at Granite City, Illinois. The area was considered "fringe" and almost all expansion was promoted through the signing of jobbers, to hold down company investment.

In May, 1952, Carl Barnes was signed as a jobber of Pioneer Oil Company products at Marble City. Carl had been a successful commission agent for Leland Refining Company for 27 years prior to becoming a Pioneer jobber. He started in business as a commission agent, by borrowing the down payment for his first tankwagon, and supplying one company-owned service station. Carl was from hardy Dutch stock, and although he quit school after completing the third grade, he figured with a sharp pencil and is a millionaire today.

When Carl became a Pioneer jobber, he converted six stations, which he owned outright, to the Pioneer brand. In addition, he converted two two-party lease accounts, two three-party lease accounts, three dealer accounts,[3] and the majority of all farm, commercial consumer, and home fuel oil accounts.

Carl bought his first property during the depression on the southeast corner of an intersection in the southwest part of the city. The primary street is also State Highway 44–C which leads out of town to the south. There is a 60-foot frontage on the primary street and 135 feet on the secondary street. He moved the house on the corner to the rear of the property, which was his home for 12 years, and built a station, hereafter known as Station B, which initially consisted of an office and a ramp for lubricating cars. Shortly afterward, he added a room for a grocery store and later added a service bay. Carl drew his own plans for this and all subsequent buildings, and did much of the work himself, or worked with those he hired. The station was immediately successful and ran as high as 20,000 gallons of gasoline per month.

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[3] A *two-party lease* account is a situation where a lease is in effect between two parties—the owner/operator and the supplier. The property is leased to the supplier and in turn leased back. There is a consideration paid in each of the leases, but usually the owner/operator receives a net rental income, as an inducement to sign the lease, which the supplier is willing to pay, to secure the volume of business. The supplier also uses the lease to insure pay-out on equipment he may have furnished and installed at the account. A *three-party lease* account involves three different people: the owner of the property leases to the supplier, who in turn leases to the operator. A *dealer account* is comparable to the two-party lease situation, except that it is usually a less desirable account, and the supplier likely does not have to furnish equipment or as much as may be the case in a two-party lease situation. In any event, there is no lease, usually only an agreement to purchase from the supplier, which probably will provide a quantity discount of purchases of oil, grease, and antifreeze.

In 1935, he purchased a 300-foot by 300-foot corner lot for $5,000.00 at the north edge of Brownsville, a little town of 500 population, 15 miles south of Marble City at the intersection of two state highways. He dismantled an old house and barn on this property and built a restaurant on the corner and a one bay station 25 feet on the south, largely of the used materials from the house and barn. A few years later he added a second service bay. While this station, hereafter known as Station C, rarely sold over 7,000 to 8,000 gallons of gasoline per month, it helped provide a "pay-run,"[4] when deliveries were made to farmers in the area, until a good farm route was built.

In 1936, he purchased an existing 17-year-old brick building on a corner in a little town of 400 population, 12 miles east of Brownsville, known as River Bend, installed two curb pumps in front, and with some alteration to the front, installed two service bays. While this station's gallonage was rarely over 6,000 gallons per month, it served the same purpose as the station at Brownsville, that is, it helped to make a pay-run in the area, while building a farm route. The River Bend station is hereafter known as Station D.

During the same year, he leased a downtown location in Marble City on a primary street only, owned by a local attorney, and built a combination station and parking lot of the area. The station, known as Station E, had no service bays, but had an outside hydraulic hoist for servicing automobiles. The station sold approximately 7,000 gallons per month.

In 1937, he purchased a large property on the southwest corner of an intersection, removed a house on the corner which he located at one end of the property, and built a three bay station for $3,700.00. This station, known as Station F, had limited depth and parking area but ran 16,000 to 17,000 gallons per month.

From 1937 until World War II started, he convinced existing station owners that they should switch brands, and he signed two of them on two-party leases, and three as dealer accounts. The two-party lease accounts were on U.S. Highway 75-A, the main highway which bypassed Marble City. One station, Station G, was a combination restaurant, service station, and trailer park, known as the 75-A Inn, and it sold about 11,000 gallons of gasoline per month. The other station had been an unbranded outlet, known as Station H, had no service bays, and averaged about 5,000 gallons per month. The dealer accounts were in small communities outlying Marble City, known as La Cord, Rome City, and Charleston, had old limited facilities, and averaged about 2,000 gallons of gasoline per month. He also leased an old station, Station I, at a downtown Marble City intersection on a three-party lease basis. This station was 60 by 80 feet and could park only two cars on the driveway, in addition to accommodating two cars at the pump island. The station sold about 6,500 gallons of gasoline per month. The operator supplemented his income by doing heavy mechanical work and driving a school bus.

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[4] A "pay-run" is an expression commonly used to mean the carrying and selling of a full load of product over a given route, rather than having to cover the same distance with a partial load. Inasmuch as the cost of the driver's time and the cost of operating the truck is nearly the same in both cases, the revenue from the full load comes closer to providing the desired profit.

In 1946, when materials were easier to obtain, Carl bought a property with 600 feet of frontage on U.S. Highway 75-A at the junction of State Highway 11-B which was highly traveled and built one of the city's finest restaurants and a service station. The service station, Station J, sold an average of 22,000 gallons of gasoline per month, and at that time was the most modern and highest gallonage service station on the bypass.

In 1951, Carl bought another plot of ground with 500 feet of frontage on U.S. Highway 75-A at the junction of State Highway 22-C, and the station he built on part of the ground was opened in May of 1952 at the time he became a Pioneer jobber. This station, Station K, sold an average of 25,000 gallons of gasoline per month.

At the time Carl decided to become a jobber, he borrowed $100,000.00 to build his bulk plant, buy equipment and inventory, and for working capital. Within three years, he had paid off his indebtedness and decided to retire. Due to tax reasons, he wished to lease rather than sell. Competitive oil company representatives who called on Mr. Barnes, learned of his desires and made various offers. The offer that he liked the best was made by Triple A Oil Company, which was as follows: a 20-year lease, on the bulk plant, with lease rental of a flat $5,000.00 per year, plus $\frac{3}{10}$ cents per gallon on the light oil through-put, with a $13,250.00 maximum for each 12-month period; and for the owned service stations as a group, 2 cents per gallon for all gallons of gasoline delivered to the stations, with a $16,000.00 minimum and an $18,000.00 maximum for each 12-month period. The offer provided that all maintenance or rebuilding would be at Triple A's expense. At the expiration of the 20-year lease period, Carl Barnes or his heirs would select an appraiser, the oil company would select an appraiser, the two appraisers already selected would select a third independent appraiser, and the group would arrive at a fair market value for the properties. Triple A Oil Company would have first option to purchase at this price.

Pioneer Oil Company would have to match this offer, if they wished to maintain the gallonage and representation they now had in this market. If they decided not to lease these properties, their only representation here would be the one old company-owned station, Service Station A, which was now selling an average of about 8,000 gallons of gasoline per month. Pioneer's division and district managers came to Marble City to evaluate the present and potential gallonage and the desirability of the properties from a marketing standpoint. They asked the district sales representative and the division real estate representative to make studies of the competition, possible population and industry shifts, traffic counts, and evaluate the older owned properties for rebuild and payout possibilities. The company engineers were called in to examine the physical condition of the properties. Mr. Barnes's present annual light oil gallonage was broken down as follows:

Owned Service Stations	*Annual Gasoline Sales*
B Station	156,000 gallons
C Station at Brownsville	96,000
D Station at River Bend	84,000
F Station	144,000
J Station at U.S. 75-A and 11-B	252,000
K Station at U.S. 75-A and 22-C	204,000
Total annual owned service station gallonage	936,000 gallons
Other Station Gallonage	
E Station	84,000 gallons
G Station	120,000
H Station	48,000
I Station	72,000
3 Dealers at La Cord, Rome City, and Charleston	60,000
Total other station gallonage	384,000 gallons
Total gasoline sales to farmers	190,000 gallons
Total gasoline sales to commercial consumers	496,000 gallons
Total sales of home fuel oils	860,000 gallons
Total bulk plant light oil gallonage	2,866,000 gallons

Considering this gallonage in light of the rent payable to Mr. Barnes, it was seen that for the owned stations, the rent payable would be the $18,000.00 maximum, (936,000 gallons times 2 cents per gallon equals $18,720) and for the bulk plant, the rent would be the $13,250.00 maximum ($5,000 flat, plus 2,866,000 gallons times $\frac{3}{10}$ cents per gallon equals $13,598).

It was the company's policy, that for three-party lease service stations, the maximum net rental cost was not to exceed 1 cent per gallon, net rental cost being the difference between the rent that is paid to the supplier and the rent received from the operators. The rents presently being received from the operators averaged 1 cent per gallon, and as long as the annual gallonage of the owned stations could be held above 800,000 gallons to meet the minimum $16,000.00 annual payment to Mr. Barnes, the company's policy on the maximum 1 cent per gallon net rental cost could be met. Any rent concessions to the operators, resulting in a rental income of less than 1 cent per gallon, or annual sales totaling less than 800,000 gallons through these outlets, would of course result in a net rental cost in excess of 1 cent per gallon to Pioneer Oil Company.

The engineer's report on the physical condition of the plant and owned service stations was as follows.

Bulk Plant

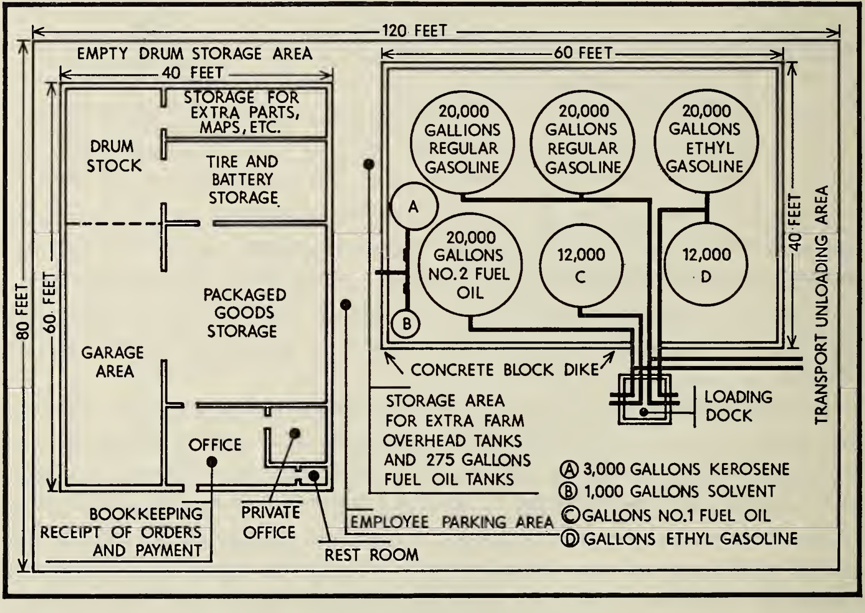
The bulk plant was built in 1952. The warehouse and office is of frame construction set on a concrete slab, except in the garage area which has a dirt floor. Walls are 2 inches by 4 inches and roofs are 2 inches by

6 inches on 24 inch centers, all covered with galvanized and corrugated steel, except for the office which is insulated lapboard. While the construction is inexpensive, it is sound with the exception that the upright roof supports in the garage area are set only on the earth floor; they should be jacked up and concrete piers poured to support them. The electrical wiring and switches in the warehouse are not explosion-proofed, which does not meet the state code. All wiring and switches at the loading dock are explosion and weather proofed.

Light oil storage consists of two 20,000 gallon tanks for regular grade gasoline, one 20,000 and one 12,000 gallon tank for premium grade gasoline, one 20,000 gallon tank for No. 2 fuel oil, one 12,000 gallon tank for No. 1 fuel oil, one 3,000 gallon tank for kerosene, and one 1,000 gallon tank for commercial solvent. All storage is upright, above ground, and enclosed in a concrete block dike, 6 feet high and of sufficient volume to meet the state fire code. (See Exhibit 1.)

EXHIBIT 1

Marble City, Illinois, Bulk Plant



There are five explosion and weather proofed pumps, one for unloading transports of product into the storage tanks, and one pump for each grade of gasoline and fuel oil. The pumps are one and three-quarter horsepower and are rated at 60 gallons per minute. The transport unloading lines are equipped with Buckeye nonsparking quick couplers. All piping is 2½ inches and is tight. There are screen traps in the transport unloading lines to keep dirt from entering the pumps and storage, and four heavy-duty filters through which each product passes before going through the pumps on the loading rack and into the tankwagons. Kerosene and solvent are pumped with hand wobble pumps.

The office is heated by a gun-type fuel oil burner which appears satisfactory. There was a final note that the packaged goods storage area was not elevated to truck bed height as was the company's usual design, to facilitate loading and unloading products. Their estimate for conduit, switches, and labor to explosion-proof the warehouse wiring was $120.00.

Station B

This single bay station is 24 years old, on a plot of ground 60 by 85 feet, with the 60 feet on the primary street. It is a combination station and grocery, of concrete block and stucco finish, except for the office and canopy which is frame and stucco. The grocery is between the station office and single service bay. The driveway is concrete. There are two pumps, with 550 gallon storage for each grade of gasoline. The tanks are original. None of the wiring is explosion-proofed, including that in the pumps. There is evidence of termite damage in the walls of the office and in the canopy. There is only one parking space on the site, which is in front of the lube door. Roofing is hotmopped tarpaper and badly weather-checked, but not leaking at this time. Island lighting consists of two 14-foot mushroom type floodlights over the pumps and one pole at the corner of the property with a cluster of spots to light the driveway entrance. The heating system consists of Coleman pot-type fuel oil space heater which is located in the station office, and Bryant gas heaters in the service bay and grocery. They appear to be in satisfactory condition. The estimate for tearing off the canopy and rebuilding the office walls is $2500.00; replacing the control panel and explosion proofing the wiring, $425.00; application of a layer of 12-pound felt and hot-mopping the roof, $50.00; and painting, $700.00. In addition, if the old mushroom-type floods on the island are to be replaced with an 8-foot florescent "T" light, there would be a cost of about $450.00 for material and labor.

Station C

This two bay station is 20 years old and of frame construction, as is the adjacent restaurant which is part of the lease package. There is a 300-foot frontage on each state highway. The drive is gravel and needs grading badly. The buildings are in poor shape and show evidence of deterioration in many areas. There are two 550 gallon tanks, one for each grade of gasoline. The tanks are original. None of the wiring is explosion-proofed and the plumbing, well, and septic system could become defective at any time. The center roof beam in the restaurant is broken, and the floor joints are layed on the earth, have decayed, and the floor sags seriously. Both the interior and exterior of the service station and restaurant need painting.

The estimate for explosion proofing the wiring at the service station was $240.00; grading and regraveling the driveway, $300.00; painting, $475.00; minimum repairs to building, $400.00; replacing the septic system, $400.00; and the replacement of the well pump and plumbing could cost as much as $400.00. It was emphasized that building repairs would be temporary. Due to the poor condition of the buildings, repair expenses could be expected to be recurrent. As the buildings were too old to be serviceable for the period of the lease, it was recommended that determination be made as to the possibility of the area supporting a rebuild.

Station D

This station is in a two-story brick building which is 36 years old. The lot is 60 feet by 100 feet, and the building sets a foot inside the sidewalk on two sides and within two feet of the property line on the other two sides. There are two curb pumps, and the two 500 gallon tanks are original and under the sidewalk. There is evidence of several roof leaks. The skylight over the lube bays must be replaced. Wiring and plumbing might fail at any time. The building is heated by a coal-fired hot water system which is sound. The brick chimney and areas of the exterior and interior brick walls need tuck pointing. The interior of the station should be repainted.

Roof repairs would consist of taking up the old tarpaper, nailing down two layers of 12-pound felt, hotmopping between the two layers and over the top layer, and replacing the skylight—all estimated at a cost of $280.00. Tuck pointing costs are estimated at $300.00; painting, $250.00; and wiring, $300.00. It is impossible to accurately estimate the extent of possible plumbing repairs as much of it is beneath concrete. It could run as high as $400.00 if the entire system had to be replaced.

Station F

This three bay station is 18 years old, constructed of concrete block with stucco finish, and on a plot of ground with 120 feet on the primary street, and 60 feet on the secondary street. There are four pumps, with one 1,000 gallon and one 550 gallon tank manifolded for each grade of gasoline. These tanks are all original. The driveway is concrete, with two 10 foot by 10 foot sections which should be replaced. The building is sound with the exception of the roof which needs to be recovered. None of the wiring is explosion-proofed and the control panel should be replaced. Exterior lighting consists of two 6-foot florescent "T" lights and sufficient clusters of spots to light driveway entrances. The station has never been painted inside since the original, and it also needs exterior painting. Two of the three overhead doors are worn out and must be replaced. The estimate for the recommended repairs was $120.00 for the roof, $500.00 for wiring, $1,100.00 for painting, $860.00 for the overhead doors, and $470.00 to replace the broken concrete sections with reinforced concrete.

Station J

This station has two service bays, is nine years old, of concrete block and stucco, and on a plot of ground with 200 feet of frontage on U.S. 75-A, and is 75 feet deep. There are six pumps, with two 1,000 gallon tanks manifolded for housebrand and two 1,000 gallon tanks manifolded for premium gasoline. The driveway is concrete, but has badly broken up and been patched with asphalt. The building, roof, wiring, and plumbing all appear to be in good condition, except that the stucco has chipped off in numerous areas. Island lighting consists of 14-foot mushroom-type floods, which should be replaced with three 8-foot florescent "T" lights. Two 4-foot florescent area-lighters should also be provided for lighting driveway entrances.

New driveway costs are estimated at $2,400.00; refinishing the stucco, $220.00; and installation of new lighting, $150.00. It was noted that this station's location was prime, and the application of a porcelain finish to the front and two sides of the station would enhance the appearance considerably. These costs were estimated at $3,200.00.

Station K

This is a two bay concrete block building which was completed in May, 1952. It has 300 feet of frontage on U.S. 75-A and 100 feet on State Road 22-C. The station has transport storage which consists of two 4,000 gallon tanks manifolded for housebrand and two 4,000 gallon tanks manifolded for premium gasoline. In addition there is a 2,000 gallon tank for diesel fuel. There are a total of nine pumps. The driveway is concrete and in good condition. Wiring and plumbing appear to be in good condition. The plumbing is not connected to the city sewage system, but has its own 1,000 gallon concrete septic tank and leach bed. The station has its own well for water, with a submersible pump that gives sufficient flow.

Island lighting consists of eight 12-foot mushroom floods with five 4-foot vertical florescent tubes around each pole. They provide very poor lighting, and should be replaced with four 4-foot "T" lights. This station should be considered also for porcelanizing to increase its attractiveness. Lighting revamp would cost $1,600.00 and porcelanizing the front and two sides of the station would cost $3,400.00.

As a final comment in the engineer's report, it was stated that in the case of the Station B, Station C, Station D, and Station F, the underground gasoline tanks were all about 20 years old and could be expected to become leakers at any time. Replacement costs would vary, depending on whether the tanks had to be covered with reinforced concrete, but would average out at $400.00 for each 1,000 gallon tank that was installed. It was particularly pointed out that the state law prohibited the replacement of gasoline tanks beneath curb pumps as was the case at River Bend (Station D).

Pioneer's division and district manager inspected the properties and studied the engineer's reports, along with a joint report from the real estate representative and the district sales representative. It was determined that Marble City was a progressive and growing city, surrounded with some of the richest farm land in the Midwest. There was an abundance of water and labor, and rail facilities. There were more than 50 different industries in Marble City. Chrysler had just built a new fabricating plant on the outskirts. Reynolds Aluminum had one of its largest plants here. Marble City actively promoted new industry, and was the market center for a nine-county area. Gasoline retail prices had been very stable here, with only one price war in its history, which lasted only two days in 1935.

The real estate representative stated that there was substantial cross truck traffic on State Road 33-C as it was a very direct route from Illinois to Ohio, and thus a rebuild at Brownsville, using one of the new combination service station and restaurant designs might pay out as a truck stop. He had found that there were no truck stops within 100 miles east or west. Truck drivers are rather clanish and the personality and appeal of the restaurant would largely determine whether they patronized the service station. If it did not go over as a truck stop, the monthly gallonage estimate on a rebuild was 10,000 gallons.

Station B was still a good location, and it appeared that it would continue to be, based on traffic count and local residential area. However, the station was unattractive and the little grocery was outdated. Whereas there were 75 little groceries some years ago, this was one of 6 remaining in the city. The division manager decided that Pioneer Oil Company didn't know anything about the grocery business, and didn't care to learn. He believed "the sooner we get out of the grocery business here, the better." The room utilized by the grocery could be converted to a second service bay, by installing an overhead door, and revamping the interior. However, the costs involved plus tearing off the canopy and rebuilding the office wall due to termite damage, and general modernization, would be extensive, and they still would have but one parking space. It would still be an unattractive old building. The property adjacent on the south could be purchased for an estimated $16,000.00, and a new building erected for $23,000.00 plus $8,000.00 for equipment and installation.

It was learned that the two three-party lease accounts, Station E and Station I, could be assigned by Mr. Barnes to Pioneer Oil Company. The rent payable to the attorney owner of Station E was a flat $110.00 per month plus 10 percent of the parking receipts, and the rent received from the operators was a flat $150.00 per month plus 10 percent of the parking receipts. Thus there was a net rental gain of $40.00 per month, a most unusual situation. The rental paid the owner of Station I was a flat $135.00 per month, while the rent received from the operator was 1 cent per gallon. At 6,000 gallons per month, the net rental cost was in excess of 1 cent per gallon. It was decided that if the lease arrangement was consummated with Mr. Barnes, and the gallonage could not be increased at this station, the lease would be dropped at its expiration which was on December 1, 1957.

The leases on Stations G and H could also be assigned by Mr. Barnes to Pioneer; they were written on a "washout" basis; that is, there was no rental paid or received, other than the consideration of $1.00 per year. The leases were written this way because Mr. Barnes had loaned money to the owners to go into business when they could not borrow elsewhere. These leases provided for primary terms expiring in 1958, with options for two 5-year renewal periods at a rental cost of 1 cent per gallon.

The division manager considered Pioneer's and other oil company experiences in converting former jobber operations to company operations. The successful jobber's business is characterized by the personal basis on which he built it. There had been many occasions when major oil companies had converted a jobber's business only to find much of it suddenly disappeared. Pioneer themselves had unfortunately experienced a case several years before in another division of the company, where within 5 years after converting a former jobber operation, they ended up with only about 10 percent of the former gallonage. It seemed that in many cases, the major oil company could not duplicate the jobber's personality and local affiliations and activities. In this case the company hoped that Mr. Charles Canfield, who had been Carl Barnes's "right-hand man" for 10 years, and who was completely familiar with bulk plant operation and the customers, could hold and build the business as a commission agent.

The division manager mentioned the fact that most of the dominant major oil companies were just beginning extensive building programs in this area. The district sales representative pointed out that he was aware of more than 15 sites in Marble City that had been recently purchased for stations. In addition, "cut-rate" companies were either building or negotiating for sites.

It was known that at this time, Pioneer would not likely be building many new stations; possibly the year's budget would only allow three or four for the entire division which covered a four state area. The division manager stated that within five years the situation would likely change, as he knew that there were plans to extend the pipeline several hundred miles north of Granite City, Illinois, during that period. When a "fringe" area was eventually followed up by pipeline, there was usually a building program designed to guarantee disposition of the products that the marketing department was committed to take.

Pioneer's district and division manager carefully weighed all of the available factors involved in the decision to be made. The long-run consideration was whether Pioneer really wanted to be in or out of this market. Deciding that this area was a desirable part of their distribution pattern, the next decision to be made was whether acquisition of Barnes's operation, under the conditions necessary, would be a profitable and generally acceptable method. At the present gallonage the operation was profitable; the degree of profitability or whether there would be profit at any point in the future would depend upon their ability to maintain and build the gallonage. Besides the influence that Pioneer could bring to bear on the situation, the external factor of competition would to a large degree determine their impact on the market. Competition was considered to be very strong. One of the strongest competitors was a major brand jobber operation handling ABC products, which was one of the 14 bulk plants owned by the largest jobber in the state of Illinois. There was one other jobber, handling the XYZ major brand products, who had been established for 27 years and was very well known and aggressive. The company, which was generally considered to be the market leader in the state, was organized here on a salaried bulk plant operation with commission tank truck salesmen. Pioneer's present gallonage in Marble City would be in a fourth place position. In addition, there were seven other major oil companies that had bulk plants operated by commission agents. Two other major oil companies had several service stations which were served direct but had no bulk plants in Marble City, and there were eight independent oil companies with service stations only. There were a total of 102 retail gasoline outlets in Marble City. Pioneer was really not very well known in the market, as they had been a factor for just three years since 1952 when Mr. Barnes became a jobber of Pioneer products.

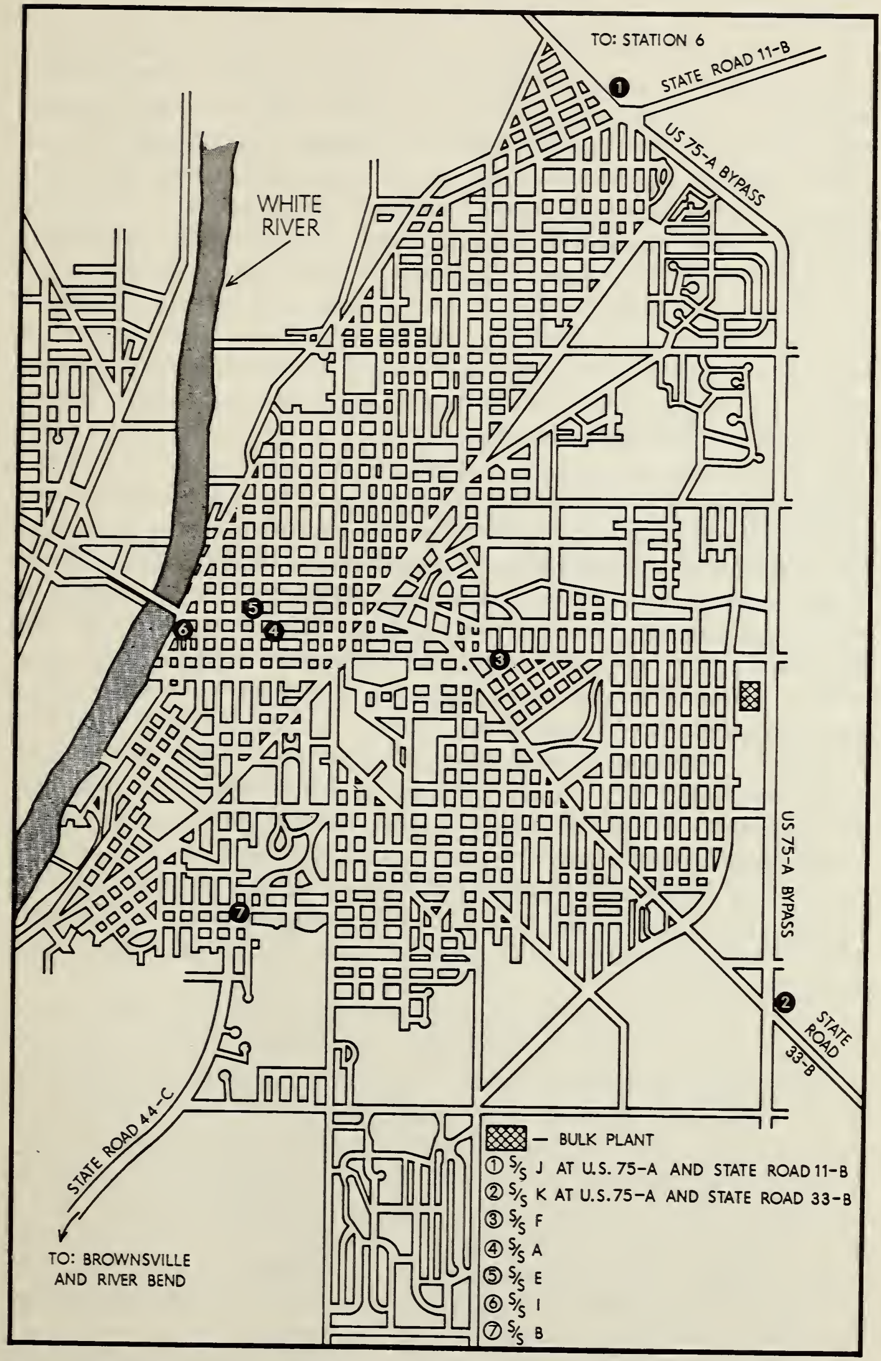
II.

The division manager made the decision to recommend to the general offices that Triple A Oil Company's competitive offer for the leasing of these properties be met. On the basis of the recommendation, approval was given and leases were drawn up and signed, effective September 1, 1955.

Mr. Van Wert purchased the five tankwagons and the pickup truck from Mr. Barnes, and was installed as commission agent. Pioneer purchased the truck tanks and all service station equipment and pumps and tanks at farm and commercial accounts from Mr. Barnes at a figure computed at a 10 percent depreciation rate. Loaned equipment agreements were signed by all customers using this equipment, and it was set up in

EXHIBIT 2

Marble City, Illinois



the company's equipment records. The full-time bookkeeper and the three full-time tank truck salesmen were retained by Mr. Van Wert as employees.

During the next three years there were many changes in the total petroleum marketing picture in Marble City. This was the boom building period for the expansion-minded oil companies. Triple A Oil Company, which had made the competitive offer that Pioneer met, pulled out of the market completely. However, one of the independent oil companies already in Marble City built a super station on the bypass with 15 pumps at a total cost of $80,000.00. An independent not previously represented here, Emperial Oil Company of Indianapolis, built a similar station just a few blocks from the other independent station on the bypass. Seven of the major oil companies built stations on the bypass, ending up with a total of 26 outlets there by the end of 1958. The market leader's previous highest gallonage station on the bypass dropped from 60,000 gallons per month to 25,000 gallons. On the north end of the bypass where there were four stations in a group, and where the area was not as well developed, there was constant turnover of lessees. There were new stations and rebuilds in many areas of the city. The cost of the ground and improvements at some of these sites were in excess of $100,000.00. While most companies seemed to consider dealer "pirating"[5] as undesirable, it became common practice by some companies. The inducement was that they had a new or newer station in a better location or simply a rent concession. There were cases where the better known top operators in town were offered stations at reduced or free rent for a period up to one year.

Pioneer considered several prospective service station sites but in every case their best offer was overbid by a competitive oil company. The winner of the bid either thought that a station on the particular site would produce higher gallonage, or, figured their payouts over a longer period than Pioneer. In one extreme case, Pioneer offered a property owner 1¾ cents per gallon with a $375.00 minimum monthly lease payment; the winning offer was 2 cents per gallon with a $600.00 monthly minimum payment.

When Pioneer leased the Marble City bulk plant and stations, they came out with an aggressive newspaper advertising schedule; the total lineage was greater than any other competitor's purchases. A budget plan which evened out home fuel oil payments was heavily advertised and found to be successful. The total heating season's requirements for each customer was estimated and divided into 10 equal payments beginning September 1. This reduced the cash outlay for heating expense which was normally highest at Christmas and taxpaying time, when people had other expenses. The automatic degree day and keep-fill system and advantages of summer-fill with price protection were advertised at other strategic times of the year. General product and services were advertised with the dealers tying in, giving their names, locations, and phone numbers. These ads were large, usually one-half page, with the dealer's only expense being the cost of the tie-in.

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[5] Pirating is an idiomatic expression used in the petroleum industry to describe the efforts used to persuade dealers to terminate their present company affiliation and join another company.

Fuel oil sales climbed steadily, reaching an all-time annual high of 1,000,000 gallons in December, 1958. Oil and grease sales to consumers were increased by the addition of new customers. Most of the necessary improvements stipulated in the engineer's report were made to the service stations, with the exception of porcelanizing exteriors which had not yet been budgeted. Despite the physical improvement, gasoline gallonage dropped. Each year, with the building and modernization of competitive stations, Pioneer's older stations with limited frontage and facilities became less competitive; company-wide and localized sales promotions did not have the desired effect. In December, 1955, the operator of the Circle Inn became insolvent; due to this stations' limited facilities the owner could not find a suitable operator and Pioneer pulled the pumps and air compressor that had been loaned to the account. In December, 1957, when the lease expired on the station at 2nd and Main Streets, it was decided not to renew, as the operation did not prove profitable. The original operator left the station to lease a new competitive station in a more desirable location the previous year. The owner of the property would not reduce the fixed rental to Pioneer, and it was felt that the station would never produce enough gallonage to bring it within the company's policy of a maximum 1 cent per gallon net rental cost.

The local XYZ jobber in Marble City bought the corner property on the north of Pioneer's station and restaurant at Brownsville and built a modern station and restaurant which reduced Pioneer's station gallonage by nearly one half. This jobber also bought a corner property at the entrance to River Bend, but as this was during the first part of the 1957 recession, he delayed the building of a service station indefinitely.

Total light oil throughput of the bulk plant was approximately the same as it had been when the plant was leased from Barnes, primarily due to increases in home fuel oil sales. In December, 1958, the gallonage of the stations owned by Barnes was as follows:

B Station at 5th and Claymore Streets	96,000 gallons
F Station at 18th and Bryant Streets	138,000
J Station at U.S. 46 and State Road 25	216,000
K Station at U.S. 46 and State Road 38	216,000
C Station at Brownsville	48,000
D Station at River Bend	66,000
Total annual sales	780,000 gallons

The district sales manager realized in his analysis of the present gallonage, that net rental cost was now a fraction of a cent in excess of 1 cent per gallon and potentially a very serious situation, calling for positive action now to "hold the line."

BIBLIOGRAPHY

Bibliography

Prepared by H. Baumgartel*

This annotated bibliography represents a somewhat personal selection process. Some valuable books which are familiar to students of business policy are missing, in part because they are so well known and in part because they do not represent a uniquely "behavioral science" approach. Other books are missing because they are ones which I am unfamiliar with myself. No attempt was made to include material on the technology of industry and commerce as such. The basic objective of this bibliography is to provide the reader, either instructor or student, with a sufficiently comprehensive book list so that he could get started on a reading program of his own, a reading program which would acquaint him with the way of thinking of the scientist and with some concrete research and theory which might be helpful in administrative analysis.

This reading list does not contain the wide variety of basic texts in business and public administration, nor does it contain basic texts in psychology, economic analysis, sociology, or anthropology. Most of the authors and editors of these books, however, are men with much practical experience in management affairs and research and with the great literature of the sciences of human behavior. You will note, for example, that the bibliography does not show those books generally listed for courses on groups and group development. The group concept and the importance of group development is nevertheless a thread that runs through sections of many books on this list. No attempt has been made to deal in any comprehensive way with problems of learning and the methods of executive development and training. Much more should be included than is on the general subject of thinking, problem solving, and diagnostic analysis. The success of any enterprise is in large measure the consequence of a series of adequate decisions concerning a variety of issues *vis-à-vis* the external environment of the organization and *vis-à-vis* the maintenance of a viable and creative internal organizational climate. To become an effective decision maker, one must acquire skill in logic and analytic thought; one must have an adequate set of concepts and theories concerning human behavior to use in diagnostic analysis; and one must have better than ordinary skills in implementing change through the people and groups which comprise organizations. Hopefully, this bibliography can provide the curious and motivated student of business with some insights and data for each of these three levels in the decision process.

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The reader should note that many of the books on this list contain themselves various bibliographies of books and articles dealing with business management and relevant theory and research in the social sciences. It is my belief that the most significant and helpful reading we do is what we discover ourselves—when we come upon a book so relevant to the issues we are struggling with that we cannot put it down.

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Adams, Richard N., and Preiss, Jack (eds.). *Human Organization Research.* Homewood, Ill.: The Dorsey Press, Inc., 1960.

This is a collection of papers first published in *Human Organization.* The papers and reports deal with a wide variety of problems in doing research. Good material for case writers.

Argyris, Chris. *Personality and Organization.* New York: Harper & Bros., 1957.

Argyris discusses and presents his basic ideas concerning the psychology of the individual in relation to the demands of formal organization. As is well known, he sees a conflict, but the book provides a worthwhile framework for understanding individual behavior.

———. *Understanding Organizational Behavior.* Homewood, Ill.: The Dorsey Press, Inc.

Argyris presents a theoretical model of organization by building on a number of research studies of organization.

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Barnard presents a theory of organization based on his study of social systems. This classic book for managers presents an analysis of the functional tasks and methods required of executives.

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Bellows and his associates have created a teaching text for executive training programs. The book draws heavily on behavioral science research of a certain kind. The focus is on the personal skills believed to be essential for success in the large organization.

Bendix, Reinhard. *Work and Authority in Industry.* New York: John Wiley & Sons, Inc., 1956.

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This is a book of readings in the application of behavioral science concepts and methods to the problems of change in groups and organizations. A valuable book for dealing with the human and social problems in improving organizational effectiveness.

Blau, Peter M. *The Dynamics of Bureaucracy.* Chicago: The University of Chicago Press, 1955.

A sociologist reports the results of a study of interpersonal relations in two government agencies. A general theory of organizational change is developed. Stimulating but abstract.

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Another collection of research papers touching on a wide variety of management problems. Technical problems in engineering psychology are covered as well as issues in marketing and consumer behavior.

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This book consists primarily of an interpretive and comparative study of the business careers of a number of men who were alumni of Carnegie Tech's Graduate School of Industrial Administration. The book is journalistic in style and the analysis is soundly based in relevant research literature. Very worthwhile.

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A book of readings and cases dealing with the sociology of organization. An excellent presentation of some important conceptual tools for organizational analysis.

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A sociologist looks at many aspects of the current industrial world: management, unions, industrial relations, and the social setting. Contains valuable bibliographic material.

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This is a book of research papers and readings in the major topic areas of the field. Excellent as a resource book. Many articles could provide excellent resource material for case analysis.

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A new text in industrial psychology which provides much resource material on organization and management. References are provided for each chapter and in total are excellent bibliography, sound and up to date. The book is a great contrast to industrial psychology texts of 20 years ago.

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A collection of recent papers by a set of significant writers among social scientists who have done research in business. Articles on human factor research, decision making are included. Appears very worthwhile.

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Mann and Neff summarize a Foundation seminar for business executives. The booklet contains stimulating ideas and a bibliography on change.

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A carefully thought-out conceptualization of a theory of formal organization. Emphasis is placed on the rational aspects of organized human effort. A very significant book by highly regarded authors. Technical and abstract.

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A presentation and elaboration of McGregor's well-known theory of human factors in management. Concrete applications are presented.

REICHENBACH, HANS. *The Rise of Scientific Philosophy.* Berkeley, Calif.: University of California Press, 1958.

A presentation of the nature of scientific thought and its intellectual basis through the historical method. A useful book for understanding the social meaning of science and its relevance to business analysis although it does not deal specifically with business phenomena.

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An integration of a variety of different research approaches to the study of organizations. Primarily sociological and administrative. Valuable as a basic reference.

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The book brings together a variety of popular articles and papers dealing with different approaches to creativity.

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This book discusses the general problems in the research process as well as specific issues in designing and carrying out field research. Problems in data collecting and interpretation are analyzed. A good book for learning about how researchers think.

Selznick, Philip. *Leadership in Administration.* Evanston, Ill.: Row, Peterson, 1957.

An insightful discussion of goal setting and adaptation to changing circumstance. Should be a valuable book for background to business policy. In the tradition of Barnard and Simon.

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This book is based on the extensive research program of the Ohio State Personnel Research Board. A down-to-earth and descriptive approach to the study of executives' behavior.

• Simon, Herbert A. *Administrative Behavior.* New York: The Macmillan Co., 1947.

Simon is in many ways the outstanding student of administration and behavior. He draws equally well upon many different disciplines as they bear upon administrative analysis. The focus is on the decision-making process.

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Papers by Dubin, Argyris, W. Lloyd Warner, W. F. Whyte, Luce, Haire, and others. Good articles on the social origins of business and government executives, and on "risky decision-making."

• Tannenbaum, R.; Weschler, I.; and Massarik, F. *Leadership and Organization: A Behavioral Science Approach.* New York: McGraw-Hill Book Co., Inc., 1961.

A book built around the research, concepts, and approach to management training of the Human Relations Research Group at U.C.L.A. The book covers many areas, generally from a psychological point of view. An excellent annotated bibliography is included. A very useful book.

Voting Research and the Businessman in Politics. Ann Arbor, Mich.: Foundation for Research on Human Behavior, 1960.

A report of one of the Foundation's seminars. Good introduction to research on political behavior. Bibliography attached.

Wasserman, Paul, and Silander, F. S. *Decision-Making: An Annotated Bibliography.* Ithaca, N.Y.: Cornell University Press, 1958.

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